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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1940

No. 517

WALTER M. HORT, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED OCTOBER 18, 1940.

CERTIORARI GRANTED NOVEMBER 25, 1940.

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United States Board of Tax Appeals.

Docket No. 89033. 1

WALTER M. HORT,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket Entries.

APPEARANCES: 2

For Petitioner: EDWIN HORT, ESQ.

For Respondent: F. S. GETTLE, ESQ.

1937

May 10—Petition received and filed. Taxpayer notified. (Fee paid.)

May 11—Copy of petition served on General Counsel.

June 12—Answer filed by General Counsel.

June 17—Copy of answer served on taxpayer.

Dec. 9—Notice issued placing proceeding on New York City Calendar. 3

1938

Oct. 18—Hearing set Nov. 28, 1938, New York, N. Y.

Nov. 28—Notice of appearance of Edwin Hort as counsel for taxpayer filed.

Nov. 30—Hearing had before Mr. Murdock on merits. Submitted. Stipulation of facts, appearance of Edwin Hort and withdrawal of Fred Van Dolsen, filed. Petitioner's brief due 12/30/38. Commissioner's brief due 1/30/39. Petitioner's reply due 2/14/39.

Docket Entries.

4 Dec. 15—Transcript of hearing 11/30/38 filed.
Dec. 30—Brief filed by taxpayer. 12/30/38 copy served.

1939

Jan. 21—Brief filed by General Counsel.
Feb. 2—Reply brief filed by taxpayer. 2/2/39 copy served.
May 19—Findings of fact and opinion promulgated—Mr. Murdock, Division 3. Decision will be entered under Rule 50.
Aug. 21—Computation of deficiency filed by General Counsel.
Aug. 23—Hearing set Sept. 6, 1939 on settlement.
5 Sept. 2—Consent to settlement filed by taxpayer.
Sept. 15—Decision entered—J. E. Murdock, Division 3.
Dec. 12—Petition for review by U. S. Circuit Court of Appeals, Second Circuit, with assignments of error filed by taxpayer.
Dec. 18—Proof of service filed by taxpayer.

1940

Feb. 8—Agreed motion for extension of time to March 26, 1940 to complete and transmit record filed.
Feb. 8—Order enlarging time to March 26, 1940 to prepare and deliver record entered.
Feb. 9—Agreed statement of evidence lodged.
6 Feb. 9—Praecipe for record filed with proof of service and agreement thereon.
Feb. 13—Agreed statement of evidence approved and ordered filed.

Petition.

[SAME TITLE.]

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (IT:A:1-MB-90D) dated February 11th, 1937 and as a basis of his proceeding alleges as follows:

1: The petitioner is an individual residing at 502 Park Avenue, New York City, New York. The petitioner formerly resided at 123 West 57th Street, New York, New York.

2. The notice of deficiency (a copy of which is attached and marked Exhibit A) was mailed to the petitioner on February 11th, 1937.

3. The tax in controversy is income tax for the year 1933 and in the amount of $59,012.62.

4. The determination of tax set forth in said notice of deficiency is based upon the following errors:

b. The Commissioner of Internal Revenue has erroneously determined that a gain of $140,000.00 was realized by the cancellation of the lease on property located at #76 Madison Avenue, New York, New York.

c. The Commissioner of Internal Revenue has erroneously computed statutory tax liability by inclusion of alleged gain of $140,000.00 from cancellation of lease as ordinary income, subject to normal and surtax rates, whereas any gain realized or loss sustained by the cancellation of the lease should be computed under the provisions of Section 101 (A) of the Revenue Act of 1932.

10 5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

K. In the year 1927, Otto Horwitz, father of the petitioner, was the owner of a loft building located at #76-78 Madison Avenue, New York City, New York. The building was a high grade loft building of approximately 750,000 cubic feet.

L. On August 31st, 1927, said Otto Horwitz, deceased, entered into a contract with American Exchange-Irving Trust Company, hereinafter referred to as the Trust Company, leasing to said Trust Company the main floor of the building for banking purposes for a term of fifteen
11 years from February 1st, 1932 at an annual rental of $25,000.00 per annum. At the time of the execution of the lease the Trust Company was in occupancy of the premises under a previous sub-lease from Blum and Koch, who held a lease on the entire building. Said sub-lease expired by its terms on February 1st, 1932, at which time the lease of the entire building with Blum and Koch also expired. The Trust Company, by taking a fifteen year lease of the premises from the owner, to commence at the expiration of the Trust Company's sub-lease, thus obtained uninterrupted possession of the premises until 1947. It was to accomplish this purpose that the lease
12 in question was made in year 1927 to commence in 1932.

M. On March 7th, 1928, Otto Horwitz died and under the decedent's will, admitted to probate on March 14th, 1928 in the Surrogate's Court of New York County, title to the property at #76-78 Madison Avenue, New York City, New York was vested in the petitioner. It then became the duty of the petitioner, as executor of his father's estate, to file a Federal Estate tax return and include therein the value of the assets of the estate. Accordingly, the petitioner engaged the services of appraisers for the

purpose of obtaining the fair market value of #76-78 Madison Avenue, New York City, New York, as of date of death of decedent, and requested from said appraisers that the valuation of that property be made on the basis of the following: 13

1. Fair Market Value of Land and Building, exclusive of leasehold.
2. Fair Market Value of leasehold based upon lease dated August 31st, 1927.

N. The appraisal was made by Albert J. Berwin Company, appraisers, of #570 Seventh Avenue, New York City, New York, and the fair value, as evidenced by such appraisal, was set forth as follows: 14

Land and Building, exclusive of lease	$480,310.00
Leasehold	169,690.00
Total Fair Value of Land, Building and Lease	$650,000.00

O. In the Federal Estate tax return filed for the estate of Otto Horwitz, the value for land, building and leasehold was included therein at the fair value of $650,000.00 as determined by the independent appraisal, set forth above, and estate tax liability was computed and paid on such valuation. 15

The appraised value of $650,000.00, as set forth in Federal Estate tax return filed, was accepted as the basis of fair value of same at date of death of the decedent by the Commissioner of Internal Revenue, after an investigation by the Field Valuation Section of the Bureau of Internal Revenue and the recommendation of said Field Valuation Section was approved by estate tax division of Bureau of Internal Revenue.

16 P. On February 1st, 1932, the Trust Company continued in possession of the premises under the lease of August 31st, 1927 between Otto Horwitz, deceased, and itself, and occupied said premises until December 1st, 1933, when for reasons of its own, it negotiated the cancellation of the lease in consideration of a payment of $140,000.00 to the petitioner.

Q. With original return filed for year 1933 by the petitioner a schedule was attached thereto showing computation of a net loss of $21,494.75 sustained as a result of cancellation of lease and receipt of $140,000.00 in consideration therefor. The amount of said loss was not
17 deducted on the return filed since the amount of other capital losses exceeded statutory gross income reported. The computation of loss of $21,494.75 was made on basis of the following:

"LOSS THROUGH CANCELLATION OF LEASE:

Lease cancelled as of December 1st, 1933. Unexpired portion of lease—December 1st, 1933 to January 31st, 1947—13 years, 2 months. Lease rental for unexpired portion of lease—$25,000.00 per annum, payable monthly, total for 13 years and 2 months, $329,166.67. Received in return for cancellation of lease, $140,000.00."

18

Estimated future rentals under present conditions:

$ 8,000.00 per annum for five years
$10,000.00 per annum for next five years
$12,000.00 per annum for next three years and two months.
Value at December 1st, 1933 of Rental of $25,000.00 per annum, payable monthly in advance, for a period of 13 years and 2 months, computed at interest rate of 4% per annum, converted annually—Forward $257,515.75

Petition.

Value at December 1st, 1933 of rental of $8,000.00 per annum for first five years; $10,000.00 per annum for next five years; $12,000.00 per annum for last period three years and two months, payable monthly in advance. Computed at interest rate of 4% per annum converted annually	$97,941.00	
Less: Real Estate brokerage fees on rentals of $8,000.00 per annum for first five years, $10,000.00 per annum for next five years and $12,000.00 per annum for next three years and two months: Total Rental of $128,000.00 at 1½%	1,920.00	96,021.00
TOTAL LOSS		$161,494.75
Liquidating damages received		140,000.00
NET LOSS SUSTAINED		$ 21,494.75

This computation was made independently of the value of the lease as determined by appraisal in 1928 for purpose of estate tax liability and is based upon known factors at time of cancellation of lease on December 1st, 1933.

R. The Commissioner of Internal Revenue has, in his determination of statutory net income, disregarded this

22 computation of loss sustained from cancellation of lease and held the amount of $140,000.00 received from same as ordinary income to the petitioner without allowance either for the value of $150,000.00 for the lease as of date of acquisition by the petitioner in 1928 or for the loss of income in amount of $161,494.75 set forth in the aforesaid computation.

S. In the year 1932 the gross annual rental received from the entire building was approximately $50,000.00 of which fifty per cent, or $25,000.00 was received under the lease with the Trust Company for main banking floor. After deducting expenses of operation, exclusive of de-
23 preciation sustained, of approximately $30,000.00, the net annual rental was approximately $20,000.00, of which more than fifty per cent was attributed to the lease with the Trust Company, since the expenses attributed to space occupied by the Trust Company were less than fifty per cent of total expenses.

T. In June, 1933 the business of the Trust Company, then located at 76 Madison Avenue, was discontinued and its business consolidated with that of the Fifth Avenue office of that Trust Company.

The Trust Company made extensive efforts to sub-lease this space at 76 Madison Avenue, since said Trust Com-
24 pany was obligated for the payment of $25,000.00 per annum until August 31st, 1942. To accomplish this, a solicitor was employed by the Trust Company, and the possibility of sub-leasing the premises was placed in the hands of forty or more prominent real estate brokers.

The efforts of solicitor employed by the Trust Company and real estate brokers with whom this property was listed for sub-lease proved unavailing with result that the Trust Company in December, 1933 proposed to the petitioner the cancellation of the lease in consideration of payment of $140,000.00.

U. After the cancellation of lease with the Trust Company in December, 1933, the petitioner listed the space formerly occupied by the Trust Company at 76 Madison Avenue, New York City, with several real estate brokers, whose efforts in renting or leasing said space were unsuccessful, and it remained vacant to date of foreclosure of the property on February 11th, 1935. 25

V. The petitioner, by the cancellation of this valuable lease for a consideration of $140,000.00, not only suffered a loss of $10,000.00, representing the difference between the appraised value of $150,000.00 for the lease in 1928 when acquired, and the amount of $140,000.00 received for the cancellation of same, *or* a loss of $21,494.75, resultant from difference between the converted value as of December 1st, 1933 of gross amount of rental to be received under the lease and estimated rental to be received for balance of the term of the lease under reduced rentals, but by the cancellation of said lease on December 1st, 1933, for a consideration of $140,000.00, lost title to the property by foreclosure and sale on February 11th, 1935. 26

W. After cancellation of the lease was effected, the income received from the property was insufficient to pay all expenses, with the result that on March 16th, 1934 a receiver was appointed on application of the mortgagee, who commenced foreclosure proceedings, resulting in a judgment of foreclosure and sale on February 11th, 1935, and the loss to petitioner of an amount in excess of $185,000.00. 27

X. The petitioner realized no taxable gain from the cancellation of lease for consideration of $140,000.00, but sustained a statutory loss of not less than $21,494.75 because of the fact that by such cancellation for consideration of $140,000.00, the petitioner not only lost estimated future rentals of a value of not less than $161,494.75, but

Exhibit A, Annexed to Petition.

because of such transaction lost right and title to the property, thereby incurring a loss in excess of $185,000.00.

WHEREFORE, the petitioner prays that this Board may hear the proceeding and determine that there is no deficiency in tax for the year 1933.

FRED VAN DOLSEN,
Counsel for Petitioner,
815 Fifteenth Street, N. W.,
Washington, D. C.

(Verified April 6, 1937.)

EXHIBIT A, ANNEXED TO PETITION.

TREASURY DEPARTMENT

WASHINGTON

Office of
Commissioner of Internal Revenue

February 11, 1937.

Mr. Walter M. Hort,
123 West 57th Street,
New York, New York.

Sir:

You are advised that the determination of your income tax liability for the taxable year(s) 1933 discloses a deficiency of $59,012.62 as shown in the statement attached.

In accordance with section 272(a) of the Revenue Act of 1932, as amended by section 501 of the Revenue Act of 1934, notice is hereby given of the deficiency mentioned. Within ninety days (not counting Sunday or a

legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency. 31

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency and will prevent the accumulation of interest, since the interest period terminates thirty days after filing the form, or on the date assessment is made, whichever is earlier. 32

Respectfully,

GUY T. HELVERING,
Commissioner.

By CHAS. T. RUSSELL
Deputy Commissioner.

Enclosures:

Statement
Form 870

33

Exhibit A, Annexed to Petition.

34 STATEMENT

IT:A:1
MB-90D

In re: Mr. Walter M. Hort,
123 West 57th Street,
New York, New York.

Income Tax Liability

Year	Income Tax Liability	Income Tax Assessed	Deficiency
1933	$59,012.62	None	$59,012.62

35 The deficiency shown herein is based upon the report dated December 27, 1934, prepared by Internal Revenue Agent Daniel A. O'Leary, a copy of which was transmitted to you.

Careful consideration has been accorded your protest dated May 22, 1935 in connection with findings of the examining officer and the information submitted at a conference held in the office of the internal revenue agent in charge and in this office.

The adjustments follow:

Excess of capital net loss over net income originally reported on your return	($172,955.13)
Add:	
(1) Excessive depreciation on rental properties disallowed	3,510.00
(2) Addition to income from cancellation of lease	140,000.00
(3) Error in addition (understatement of income)	10.00
(4) Decrease in capital net loss ($184,648.39 to $17,113.14)	167,535.25

36

Exhibit A, Annexed to Petition.

37

Revised net income less capital net loss adjusted $138,100.12

Explanation of Changes

(1) Depreciation claimed	$ 18,750.00
Depreciation allowed	15 240.00
Depreciation disallowed	$ 3,510.00

In your return as originally filed you claimed depreciation in the amount of $18,750.00 as follows:

38

	Acquired	Age when Acquired	Probable Life	Cost	Depreciation Claimed
(a) Loft Building	March 7, 1928	20 years	20 years	$375,000	$11,250.00
(b) Apartment House	March 7, 1928	10 years	10 years	130,000	3,900.00
(c) Apartment House	March 7, 1928	10 years	10 years	130,000	3,600.00
Total					$18,750.00

Depreciation has been allowed as follows:

			Value of Building	Allowed
(a)	10	33⅓	$300,000	$ 9,000.00
(b)	10	33⅓	108,000	3,240.00
(c)	10	33⅓	100,000	3,000.00
				$15,240.00
Disallowed				$ 3,510.00

39

In 1927 Otto Horwitz, the owner of premises (which is the subject of the lease) located at 76 Madison Avenue, New York, New York, negotiated a contract with the Irving Trust Co., by the terms of which the said corporation would pay $25,000.00 rental per year for fifteen years beginning in 1932. At the time of the execution of this lease, on or about August 31, 1927, the tenant bank was in occupancy of the premises under a prior sublease from Blum and Koch who held a lease on the entire building.

Exhibit A, Annexed to Petition.

40 This sublease expired by its terms in February 1932 simultaneously with the lease on the entire building. By taking a fifteen-year lease of the premises from the owner to commence at the expiration of the sublease, uninterrupted possession of the premises until 1947 was accomplished. It was for this purpose that the lease in question was entered into. In 1928 Otto Horwitz died and under his will bequeathed the said premises to you.

On December 1, 1933, you entered into an agreement with the Irving Trust Company, New York, New York, whereby for cancellation of the lease you received $140,000.00.

41 This amount has been considered income to the lessor for the year in which received.

The Goerke Co. v. *Commissioner,* 7 B.T.A. 860;
Farrelly-Walsh Inc., 13 B.T.A. 923;
August Merckens, 7 B.T.A. 32;
Taylor v. *Commissioner,* 17 B.T.A. 1108; Affirmed—51 Fed. (2)—915 Court Decision 459 (Certiorari denied February 15, 1932).

3. An understatement of $10.00 in total income as reported on line 12.

42 4. Capital losses from sales of property disallowed:

404 West 115th Street, New York	$76,026.75
405 West 118th Street, New York	91,508.50
Total	$167,535.25

You failed to furnish sufficient information to substantiate the fact that the completion of the sales of these properties was consummated in 1933.

Exhibit A, Annexed to Petition.

COMPUTATION OF TAX.

Revised net income less capital net loss adjusted		$138,100.12
Capital net loss (adjusted)		17,113.14
Income subject to surtax		$155,213.26
Less:		
Dividends	$ 497.50	
Personal exemption	1,000.00	1,497.50
Income subject to normal tax		$153,715.76
Normal tax at 4% on $4,000.00		$ 160.00
Normal tax at 8% on $149,715.76		11,977.26
Surtax on $155,213.26		49,014.50
Total tax		$ 61,151.76
Less:		
Credit of 12½% of capital net loss of $17,113.14		2,139.14
Correct income tax liability		$59,012.62
Tax previously assessed, account #678473		None
Deficiency		$59,012.62

A copy of this letter has been mailed to your representative, Mr. C. R. Pollard, Shoreham Building, Washington, D. C., in accordance with the authority conferred upon him in the power of attorney executed by you and on file with the Bureau.

Answer.

46

[SAME TITLE.]

Now comes the respondent, by his attorney Morrison Shafroth, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition of the above-named taxpayer, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

47

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits the tax in controversy is income tax for the year 1933. Denies the remainder of the allegations contained in paragraph 3 of the petition.

4. (a), (b), (c). Denies the Commissioner erred in respect to the matters alleged in sub-paragraphs (a), (b) and (c), of paragraph 4 of the petition.

K. Admits the allegations contained in sub-paragraph K of paragraph 5 of the petition.

48

L. Admits that on August 31, 1927 said Otto Horwitz, deceased, entered into a contract with American Exchange-Irving Trust Company (referred to hereinafter as the "Trust Company", leasing to the said Trust Company the main floor of the aforesaid building for fifteen years from February 1, 1932. Further admits at the time of the execution of the lease the Trust Company was in occupancy of the premises under a previous sublease from Blum and Koch, who held a lease on the entire building and that said sub-lease expired by its terms on

February 1, 1932, at which time the lease of the entire 49
building with Blum and Koch also expired. Denies the remainder of the allegations contained in sub-paragraph L of paragraph 5 of the petition.

M. Admits that on March 8, 1925 Otto Horwitz died and that under his will the petitioner inherited the aforesaid building. Denies the remainder of the allegations contained in sub-paragraph M of paragraph 5 of the petition.

N. Denies the allegations contained in sub-paragraph N of paragraph 5 of the petition.

O. Denies the allegations contained in sub-paragraph 50
O of paragraph 5 of the petition.

P. Admits that in 1933 the Trust Company negotiated the cancellation of the lease in consideration of a payment of $140,000 to the petitioner. Denies the remainder of the allegations contained in sub-paragraph P of paragraph 5 of the petition.

Q. Admits that with the original return filed for the year 1933 by the petitioner a schedule was attached thereto showing computation of an alleged net loss of $21,494.75, alleged to have been sustained as a result of the cancellation of the lease and receipt of $140,000.00 in consideration therefor. Further admits the amount of 51
the alleged loss was not deducted on the return filed for the year 1933. Denies the remainder of the allegations contained in sub-paragraph Q of paragraph 5 of the petition.

R. Admits that the Commissioner has in his determination of statutory net income disregarded the computation of the alleged loss from the cancellation of the lease and held that the amount of $140,000.00 received from same as ordinary income to the petitioner without

52 any allowance for any alleged value of the lease or alleged loss of income therefrom. Denies the remainder of the allegations contained in sub-paragraph R of paragraph 5 of the petition.

S, T, U, V, W, X. Denies the allegations contained in sub-paragraphs S to X, inclusive, of paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation contained in taxpayer's petition, not hereinbefore admitted, qualified or denied.

53 WHEREFORE it is prayed that taxpayer's appeal be denied.

MORRISON SHAFROTH,
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:

J. E. MARSHALL,
C. R. MARSHALL,
Special Attorneys,
Bureau of Internal Revenue.

54

Findings of Fact and Opinion.

55

[SAME TITLE.]

Promulgated May 19, 1939.

1. YEAR OF LOSS.—Where the offer of a taxpayer to sell real estate was accepted in 1933, and, thereafter in that year, deeds were delivered to the purchaser, possession was taken by the purchaser, and the purchaser put up collateral for payment of the purchase price, the seller sustained loss from the disposition of the property in 1933 rather than in a later year.

56

2. CANCELLATION OF LEASE.—An amount received by the taxpayer from a lessee for the cancellation of a lease was taxable in its entirety as ordinary income and no loss was sustained, either in the amount of the difference between future rentals under the lease and future rentals for the same term obtainable from other tenants, or in any other amount.

EDWIN HORT, ESQ., for the petitioner.

F. S. GETTLE, ESQ., for the respondent.

57

The Commissioner determined a deficiency of $59,012.62 in income taxes of the petitioner for the calendar year 1933. The first issue is whether certain capital losses were sustained in 1933 or whether they were not sustained until 1934. The second issue is whether the petitioner realized ordinary taxable income of $140,000 from the cancellation of a lease in the taxable year, whether it was capital gain, or whether he sustained a loss from that transaction.

58

FINDINGS OF FACT.

The petitioner is an individual, who filed his income tax return for the calendar year 1933 with the collector of internal revenue for the second district of New York.

He acquired two parcels of improved real estate in 1928 by bequest from his father. He made an offer on March 27, 1933, to sell the properties to a corporation. The purchaser was to take the properties subject to existing encumbrances and was to pay, in addition, $5,000 for one of the properties and $7,500 for the other. Of the purchase price, $1,500 was to be paid upon delivery of the
59 deeds. The balance was to be paid in five annual payments thereafter. The offer specified that the stock of the corporation should be placed with the seller as collateral for the payments. The offer was subject to acceptance by the corporation on or before December 31, 1933. The corporation accepted the offer on December 28, 1933.

The petitioner, on the latter date, executed and delivered warranty deeds for the property to the corporation. The corporation entered into possession of the premises on that same day and delivered its stock to the petitioner. The deeds were recorded on January 11, 1934. The initial payment of $1,500 was not made at the time
60 of the delivery of the deeds. The petitioner orally consented to an extension of the time for that payment and the payment was made within the extension on January 26, 1934. The petitioner continued to hold the stock of the corporation until January 1936, at which time notes of the corporation were substituted as collateral and the stock was returned to the corporation. The corporation made additional payments on the purchase price at various times but not in strict accordance with the terms of the agreement. A small balance of the purchase price still remained unpaid at the time of the hearing of this

case on November 30, 1938. The petitioner did not receive any rentals from the properties which accrued after December 28, 1933. He was never a stockholder of the corporation. 61

The capital loss of $167,535.25, which the petitioner sustained from the sale of the above mentioned properties was sustained in the calendar year 1933.

The petitioner also acquired by bequest from his father a property at 76-78 Madison Avenue, in New York City. The property was improved with a 10-floor modern fireproof commercial and office building. A trust company was occupying a part of the property as lessee at the time the father acquired the property. That lease was to 62 expire on February 1, 1932. The father entered into an agreement with the trust company on August 31, 1927, whereby he leased the main floor and basement of the building to the trust company for a term of 15 years beginning on February 1, 1932, at an annual rental of $25,000. The fair market value of the entire property at the time of the father's death on March 7, 1928, was $650,000. The trust company continued to occupy the main floor and basement until June 1933, at which time it discontinued that branch office.

A change in the neighborhood where the property was located began to be noticed in 1933. Manufacturers, who had given the neighborhood a definite business character, 63 were moving away and there was a consequent depreciation in the value of the building as business property. The trust company, although it made every effort to sublease the first floor and basement between June and December 1933, for a rental of about $15,000, was unable to find any tenant willing to give more than from four to eight or nine thousand dollars. The trust company then negotiated with the petitioner for cancellation of the lease. They entered into an agreement on December 1, 1933, whereby the lease was canceled upon the payment

64 to the petitioner on that same day of $140,000. The petitioner lost the property through foreclosure in 1935.

The petitioner reported in his income tax return for 1933 a loss of $21,494.75 as a result of the cancellation of the lease, but did not claim the amount as a deduction from income because other capital losses claimed exceeded his income.

The $140,000 received from the trust company was ordinary income received and realized by the petitioner in the calendar year 1933.

All facts contained in the stipulation filed by the parties are incorporated herein by this reference, whether or not
65 referred to above.

OPINION.

MURDOCK: The parties are in agreement that the petitioner sustained a capital loss of $167,535.25 from the sale of the two properties to the corporation. The petitioner contends that the loss was sustained in the calendar year 1933, whereas the respondent contends that it was not sustained until 1934. The court said in *Commissioner* v. *Union Pacific Railroad Co.*, 86 Fed. (2d) 637:

A closed transaction for tax purposes results from a
66 contract of sale which is absolute and unconditional on the part of the seller to deliver to the buyer a deed upon payment of the consideration and by which the purchaser secures immediate possession and exercises all the rights of ownership. The delivery of a deed may be postponed and payment of part of the purchase price may be deferred by installment payments; but for taxing purposes it is enough if the vendor obtains under the contract the unqualified right to recover the consideration.

The evidence in the present case shows that the sale actually took place in 1933. The corporation accepted the

petitioner's offer, deeds conveying title were delivered, the capital stock of the corporation was delivered to the petitioner as security for the payment of the purchase price, and the corporation took possession of the properties on December 28, 1933. The petitioner was then committed absolutely to the transaction, and he sustained the loss at that time. 67

The respondent contends that the evidence fails to show delivery of the stock to the petitioner during the year 1933. The petitioner did not state specifically the exact time at which he received the stock. The contract provided that the stock was to be delivered at the time of the delivery of the deeds. The deeds were delivered on December 28, 1933. The petitioner testified that he received the stock, and he further testified that the only modification of the contract was the extension of the time for payment of the first installment of the purchase price. The finding has therefore been made that he received the stock on December 28, 1933. But the result would be no different if he had not received the stock on that date. The payment of the first installment of the purchase price was not a condition precedent to the sale. The petitioner expressly provided when he extended the time for payment that it was not to affect the sale on December 28, 1933. He unqualifiedly parted with his property in that year and received in exchange a right to receive the purchase price. The Commissioner erred in disallowing this item as a loss for 1933. *Cf. Henry F. McCreery,* 4 B. T. A. 967; *A. H. Fell,* 7 B. T. A. 263; *Dee Furey Mott,* 35 B. T. A. 195; *C. R. Dashiell,* 36 B. T. A. 313; affd., 100 Fed. (2d) 625; *Huntington National Bank, Trustee,* 32 B. T. A. 342; affd., 90 Fed. (2d) 876; *Schoellkopf Aniline & Chemical Works, Inc.* v. *United States,* 77 Ct. Cls. 529; *Standard Lumber Co.,* 28 B. T. A. 352; *Davidson & Case Lumber Co.* v. *Motter,* 14 Fed. (2d) 137. 68 69

The remaining question is to determine the income tax consequences of the payment to the petitioner of $140,000 by the trust company in cancellation of the lease on the

70 petitioner's property. The petitioner contends that he sustained a loss on the cancellation of the lease. He claims his loss is the difference between the total rent payable under the lease for the unexpired term and the probable total rental which might be obtained for that period from other tenants. There are several reasons why the petitioner is not entitled to deduct that amount or any other as a loss in computing his income tax liability for the calendar year 1933. The alleged loss as described by the petitioner represents only the amount of earnings which he expected to obtain from the use of his property but which he probably will never receive.
71 A mere reduction in the amount of income to be expected does not give rise to a deductible loss. *Frank F. Nicola,* 1 B. T. A. 487; *John F. Blanchard,* 17 B. T. A. 1271; *H. I. Josey,* 38 B. T. A. 497. Failure to prove the present value of the future payments under the lease at the close of 1933 and the then value for rental purposes of the first floor and basement for a similar period independent of the lease is of no consequence. Comparison of those two figures would show the then value of the lease or the probable loss of future earnings which the petitioner could expect as a result of the cancellation of the lease, but such a comparison would not show any figure important in the computation of any loss for income tax
72 purposes.

The petitioner has failed to prove any figures from which a loss could be computed. A loss from the disposition of property is computed for income tax purposes by deducting the amount realized from the adjusted basis. The amount realized from the cancellation of the lease was $140,000. Basis is always cost or some substitute therefor authorized by the revenue act. Where, as here, property was acquired by bequest in 1928, the basis would be the fair market value of the property in 1928. The evidence does not show any separate basis for the

lease in question in the hands of this petitioner or that 73
the lease had any value in itself at the time that the property was acquired by this petitioner. Certainly there is no reason to believe that the lease had a value at that time which, after adjustment for exhaustion up to the close of 1933, would exceed $140,000, the amount realized. The land and building had a basis for gain or loss in his hands. But he did not dispose of that property, and he sustained no loss in regard to it. Even if there was a shrinkage in the value of that property, he would still not be entitled to any loss on that account. Thus, even if on some theory the petitioner might be entitled to a loss, nevertheless, he has failed to prove that in fact any 74
loss was sustained.

This lease cost the petitioner nothing and we must assume, in accordance with the Commissioner's determination, that it had no basis in his hands for gain or loss. The payment of $140,000 which he received was income. *H. I. Josey, supra. Cf. Langwell Real Estate Corporation;* 47 Fed. (2d) 841, reversing 17 B. T. A. 196.

The final argument of the petitioner is that if the $140,000 was income, it was capital gain rather than ordinary income. Capital gain is defined in section 101(c)(1) of the Revenue Act of 1932 as a gain from the sale or exchange of capital assets. A sale or exchange involves a transfer of property in goods. Williston on Sales (2d 75
Ed.), vol. 1, ch. 1. Here the lease was extinguished, not sold or exchanged. The lessee did not acquire any valuable asset but merely obtained a release from his liabilities under the lease. The Supreme Court has held recently in *Fairbanks v. United States,* — U. S. — (3/27/39), that "payment and discharge of a bond is neither sale nor exchange within the normally accepted meaning of the words" and the gain derived from the redemption of bonds is not a capital gain. Likewise, it has been held that the settlement of a note for less than its face value is not a sale

76 or exchange and does not give rise to a capital loss. *Hale* v. *Helvering*, 85 Fed. (2d) 819. Similar holdings have been made in regard to the voluntary surrender of a life insurance and annuity contract and in regard to liquidated damages for failure to perform a contract for the purchase of stock. *Frank J. Cobbs*, 39 B. T. A. — (3/22/39); *George A. Hellman*, 33 B. T. A. 901; *A. M. Johnson*, 32 B. T. A. 156. *Cf. James R. Stewart*, 39 B. T. A. — (1/12/39). Neither business men nor lawyers refer to the cancellation or forfeiture of a lease for a consideration as a sale or exchange. The $140,000 received by the petitioner is not capital gain but is taxable
77 to the petitioner as ordinary income. *H. I. Josey, supra.*

Decision will be entered under Rule 50.

Decision.

[SAME TITLE.]

78 The respondent, on August 21, 1939, filed a proposed computation, pursuant to the Board's Findings of Fact and Opinion promulgated May 19, 1939. The petitioner, on September 2, 1939, filed a notice of acquiescence to said computation. Therefore, it is

ORDERED and DECIDED: that there is a deficiency in income tax for the year 1933 in the amount of $38,070.71.

(Signed) J. E. MURDOCK,
Member,
United States Board of Tax Appeals.

Entered: Sep 15 1939

Petition for Review.

79

[SAME TITLE.]

To the Honorable, the Judges of the United States Circuit Court of Appeals for the Second Circuit:

I.

JURISDICTION.

WALTER M. HORT, your petitioner, respectfully petitions this Honorable Court to review the decision of the 80
United States Board of Tax Appeals entered on September 15, 1939, and finding a deficiency in income tax due from your petitioner for the calendar year 1933, in the amount of $38,070.71.

Your petitioner, at the time of filing this petition, is a citizen of the United States, and resides at 115 Central Park West, Borough of Manhattan, City of New York, State of New York.

The return of income tax in respect of which the aforementioned tax liability arose was filed by your petitioner with the Collector of Internal Revenue for the Second Collection District of New York, located in 81
the City of New York, State of New York, which is located within the jurisdiction of the Circuit Court of Appeals for the Second Judicial Circuit.

II.

NATURE OF CONTROVERSY.

Transactions re premises 76 Madison Avenue, New York City.

82 In the year 1927 the father of the petitioner was the owner of a loft building located at 76 Madison Avenue, New York City, New York. The building was a high grade loft building of approximately 750,000 cubic feet.

On August 31, 1927, petitioner's father, now deceased, entered into a contract with American Exchange-Irving Trust Company, hereafter referred to as the Trust Company, leasing to said Trust Company the main floor of the building for banking purposes for a term of fifteen years from February 1, 1932, at an annual rental of $25,000.00 per annum. At the time of the execution of the lease the Trust Company was in occupancy of the
83 premises under a previous sub-lease from Blum & Koch, who held a lease on the entire building. Said sub-lease expired by its terms on February 1, 1932, at which time the lease of the entire building with Blum & Koch also expired. The Trust Company, by taking a fifteen year lease of the premises from the owner, to commence at the expiration of the Trust Company's sub-lease, thus obtained the right to uninterrupted possession of the premises until 1947. It was to accomplish this purpose that the lease in question was made in the year 1927 to commence in 1932.

On March 7, 1928 petitioner's father died and under said decedent's Will, admitted to probate on March 14,
84 1928 in the Surrogate's Court of New York County, title to the property at 76 Madison Avenue, New York City, New York, was vested in the petitioner. It then became the duty of the petitioner, as executor of his father's estate, to file a Federal estate tax return and include therein the value of the assets of the estate. Accordingly, the petitioner engaged the services of appraisers for the purpose of obtaining the fair market value of 76 Madison Avenue, New York City, New York, as of the date of the death of the decedent.

The appraisal was made by Albert J. Berwin Company, of #570 Seventh Avenue, New York City, New York, and the fair value, as evidenced by such appraisal, was set forth as follows: 85

Land and Building—$650,000.00

In the Federal estate tax return filed for the estate of said decedent, the fair market value of the entire property was determined at $650,000.00, and estate tax liability was computed and paid on such valuation.

On February 1, 1932, the Trust Company continued as lessee of the premises under the lease of August 31, 1927 between said decedent and itself until December 1, 1933, when said lease was cancelled under the circumstances hereinafter set forth. 86

In June 1933 the business of the Trust Company, then located at 76 Madison Avenue, Borough of Manhattan, City of New York, was discontinued, and its business consolidated with that of the Fifth Avenue office of the Trust Company in the Borough of Manhattan, City of New York.

Thereafter between June 1933 and December 1933 the Trust Company made extensive efforts to sub-lease said space at 76 Madison Avenue. To accomplish this, a solicitor was employed by the Trust Company, and the matter of sub-leasing the premises was placed in the hands of forty or more prominent real estate brokers, but the character of the neighborhood had considerably changed and deteriorated since the making of the lease about six years previously, at the annual rental of $25,000.00, and the Trust Company received no offer to sub-let the space at a rental in excess of about $6,000.00 per annum. 87

In December 1933 the Trust Company proposed to the petitioner the cancellation of the lease in consideration of payment of $140,000.00 by the Trust Company.

88 This proposal was accepted by the petitioner, and the lease was cancelled and the petitioner received said sum in December 1933.

Thereafter in the year 1935 the property in question, 76 Madison Avenue, New York City, was lost to the petitioner through mortgage foreclosure sale which resulted in a deficiency, and the petitioner received no surplus moneys or other moneys from the proceeds of said sale.

During the interim between the cancellation of the lease in December 1933 and the foreclosure sale in 1935, the petitioner made reasonable efforts through
89 brokers to re-let the space formerly occupied by the Trust Company in said premises. Such efforts were unsuccessful, and the space still remained vacant and unrented at the time of the foreclosure. Subsequent to the foreclosure, the space still remained unrented until March 1, 1937, when two-thirds of the space was rented by the trustee for bondholders who was in possession of the premises, for use as a pharmacy for a term commencing March 1, 1937 and expiring February 28, 1943, at an annual rental of $4,200.00, and later the remaining third of the space was rented for use as a printing shop, for a term commencing on November 1, 1937, and expiring on January 31, 1941, at an annual rental of
90 $1,200.00 to February 1, 1938, and thereafter at an annual rental of $1,800.00 to the expiration of the term.

According to experts duly qualified on the subject, the rental value of the space in question from the time of the cancellation of the lease on December 1, 1933 to the expiration of the original term of the lease, February 1, 1947, was at the rate of about $5,500.00 a year, and that neither at the time of the cancellation of the lease nor at any time subsequent thereto down to the expiration of the original term, could the space be re-let upon as favorable terms as the original lease.

The Commissioner contended that the entire sum of 91
$140,000.00 received by the petitioner as the consideration for the cancellation of the lease was income of the petitioner for the taxable year 1933.. The petitioner contended that the transaction in question did not result in any income or gain, but in a loss, because the petitioner lost the value of a valuable lease which he had inherited, and upon the value of which he paid estate taxes. Said lease, at the date of cancellation provided for a rental of $25,000.00 a year for an unexpired term of thirteen years and two months, totaling $329,166.67. The tenant was a financially responsible bank. The petitioner received only $140,000.00 in cash for this asset, with no 92
recoupment and no possibility of any, as he lost the property before it could be re-let, and then it could be re-let only at a loss of about $19,000.00 per annum from the amount of the original rent reserved in the lease.

The Commissioner further contended that if said $140,000.00 was income, it was ordinary income, and not capital gain. The petitioner contended that if it were income, it was capital gain, and was more than offset by capital losses on other transactions set forth in the petitioner's return for the taxable year, and that therefore there was no deficiency.

III. 93

Assignment of Errors.

In making its decision as aforesaid, the United States Board of Tax Appeals committed the following errors upon which your petitioner relies as the basis of this proceeding:

1. The Board erred in finding that the loss represented only loss of expected earnings.

94 2. The Board erred in finding that the lease cost the petitioner nothing, and that it had no basis in the petitioner's hands for gain or loss.

3. The Board erred in finding (if it did so find) that there was a failure to prove the present value of the future payments under the lease at the close of 1933, and the then value for rental purposes of the demised space for a similar period.

4. The Board erred in holding that the sum of $140,000.00 received by the petitioner as the consideration for the cancellation of the lease was income.

95

5. The Board erred in holding that the petitioner could not deduct or offset from the said $140,000.00 the amount of loss sustained by him arising from the cancellation of the lease.

6. The Board erred in holding that the petitioner failed to prove any figures from which a loss could be computed.

7. The Board erred in holding that if the said sum of $140,000.00 was income, it was ordinary income and not capital gain.

96

8. The Board erred in holding that there was any deficiency in income tax for the year 1933.

WHEREFORE, your petitioner prays that this Honorable Court may review the decision and order of the United States Board of Tax Appeals and reverse and vacate the same and determine that there is no deficiency in income taxes of the petitioner for the calendar year 1933; and for the entry of such further orders and direc-

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tions as shall by this Court be deemed meet and proper, in accordance with law.

EDWIN HORT,
Attorney for Petitioner,
Office & P. O. Address,
141 Broadway,
Borough of Manhattan,
City of New York.

(Verified December 8, 1939.)

98

Notice of Filing Petition for Review and Acknowledgment of Service Thereof.

[SAME TITLE.]

To:
COMMISSIONER OF INTERNAL REVENUE,
Internal Revenue Building,
Washington, D. C.

99

J. P. WENCHEL, ESQ.,
Attorney for Respondent,
Chief Counsel,
Bureau of Internal Revenue,
Internal Revenue Building,
Washington, D. C.

YOU ARE HEREBY NOTIFIED that on the 12th day of December, 1939, a petition for review by the United States Circuit Court of Appeals for the Second Circuit

of the decision of the United States Board of Tax Appeals heretofore rendered in the above entitled cause, was filed with the Clerk of the Board. A copy of the petition as filed is attached hereto and served upon you.

Dated: December 12, 1939.

EDWIN HORT,
Attorney for Petitioner,
Office & P. O. Address,
141 Broadway,
Borough of Manhattan,
City of New York.

Service of the foregoing notice of filing and a copy of the petition for review is hereby acknowledged this 14th day of December, 1939.

J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue,
Attorney for Respondent.

Stipulated Facts.

[SAME TITLE.]

IT IS HEREBY STIPULATED between the respective parties hereto, that the following facts are admitted for the purpose of the trial of this proceeding, reserving the right to either party to offer additional evidence not in conflict with the facts stipulated herein and reserving

the right of either party to object to the materiality of any of the facts set out herein. 103

Transactions re premises 76 Madison Avenue, New York City.

9. In the year 1927, Otto Horwitz, father of the petitioner, was the owner of a loft building located at 76-78 Madison Avenue, New York City, New York. The building was a high grade loft building of approximately 750,000 cubic feet.

10. On August 31st, 1927, said Otto Horwitz, deceased, entered into a contract with American Exchange-Irving Trust Company, hereafter referred to as the Trust Company, leasing to said Trust Company the main floor of the building for banking purposes for a term of fifteen years from February 1st, 1932, at an annual rental of $25,000.00 per annum. At the time of the execution of the lease the Trust Company was in occupancy of the premises under a previous sub-lease from Blum & Koch, who held a lease on the entire building. Said sub-lease expired by its terms on February 1st, 1932, at which time the lease of the entire building with Blum & Koch also expired. The Trust Company, by taking a fifteen year lease of the premises from the owner, to commence at the expiration of the Trust Company's sub-lease, thus obtained the right to uninterrupted possession of the premises until 1947. It was to accomplish this purpose that the lease in question was made in the year 1927 to commence in 1932. 104 105

11. On March 7th, 1928, Otto Horwitz, died and under decedent's Will, admitted to probate on March 14th, 1928 in the Surrogate's Court of New York County,

106 title to the property at 76-78 Madison Avenue, New York City, New York, was vested in the petitioner. It then became the duty of the petitioner, as executor of his father's estate, to file a Federal Estate tax return and include therein the value of the assets of the estate. Accordingly, the petitioner engaged the services of appraisers for the purpose of obtaining the fair market value of 76-78 Madison Avenue, New York City, New York, as of date of death of decedent.

12. The appraisal was made by Albert J. Berwin Company, of #570 Seventh Avenue, New York City, New York, and the fair value, as evidenced by such
107 appraisal, was set forth as follows:

Land and Building $650,000.00

13. In the Federal Estate tax return filed for the Estate of Otto Horwitz, the value of the property was included therein at the fair market value of $650,000.00 as determined by the independent appraisal, set forth above, and estate tax liability was computed and paid on such valuation.

14. On February 1st, 1932, the Trust Company continued in possession of the premises under the lease of
108 August 31st, 1927 between Otto Horwitz, deceased, and itself, and occupied said premises until December 1st, 1933, when by mutual consent of the petitioner and the said Trust Company, said lease was cancelled in consideration of the payment of $140,000.00 to the petitioner. A copy of said cancellation is hereto annexed, and hereby made a part hereof marked "Petitioner's Exhibit 5".

15. With original return filed for year 1933 by the petitioner a schedule was attached thereto showing a

computation of an alleged net loss of $21,494.75 sustained as a result of cancellation of lease and receipt of $140,000.00 in consideration therefor. The amount of said alleged loss was not claimed as a deduction on the return filed since the amount of other alleged capital losses exceeded gross income reported. 109

16. In June 1933, the business of the Trust Company, then located at 76 Madison Avenue, Borough of Manhattan, City of New York, was discontinued and its business consolidated with that of the Fifth Avenue office of that Trust Company in the Borough of Manhattan, City of New York. 110

17. Thereafter between June 1933 and December 1933 the Trust Company made extensive efforts to sub lease said space at 76 Madison Avenue. To accomplish this, a solicitor was employed by the Trust Company, and the matter of sub leasing the premises was placed in the hands of forty or more prominent real estate brokers.

18. In December 1933, the Trust Company proposed to the petitioner the cancellation of the lease in consideration of payment of $140,000.00.

Dated: New York, November , 1938. 111

EDWIN HORT,
Attorney for Petitioner.

J. P. WENCHEL,
E. C. A.,
Attorney for Respondent.

PETITIONER'S EXHIBIT 5, ANNEXED TO STIPULATED FACTS.

112 THIS INDENTURE, made the 15th day of December in the year one thousand nine hundred and thirty three BETWEEN IRVING TRUST COMPANY (formerly known as American Exchange Irving Trust Company) a New York corporation, having an office and its principal place of business at No. 1 Wall Street, Borough of Manhattan, City and State of New York, party of the first part,

—and—

WALTER M. HORT, of the Borough of Manhattan, City, County and State of New York, party of the second part.

113 WHEREAS, the predecessor in interest of said party of the second part, by a certain Indenture of Lease bearing date the 31st day of August 1927 did demise and to farm let unto American Exchange Irving Trust Company (now known as Irving Trust Company), the second floor, store and basement (excluding any vault space underneath the sidewalks and excluding the space then occupied by boilers, machinery, etc., then constituting the engine room and coal bins) in the building known as Nos. 76-78 Madison Avenue, southwest corner of 28th Street and Madison Avenue, in the Borough of Manhattan, City, County and State of New York, which

114 lease was recorded in the Office of the Register of the County of New York, on November 10, 1927, in Liber 3634, Page 336 of Conveyances, and indexed under Block Number 857 on the "Land Map of the County of New York"

NOW THESE PRESENTS WITNESS, that for and in consideration of the sum of One Hundred and Forty Thousand ($140,000) dollars, paid by said party of the second part to the said party of the first part at the sealing and delivery of these presents, the receipt whereof is hereby

Petitioner's Exhibit 5.

acknowledged, and to the intent and purpose that the said term in the said land and premises may be wholly merged and extinguished, the said party of the first part has given, granted and surrendered, and by these presents does give, grant and surrender unto the said party of the second part and his administrators, executors and assigns, heirs, all the said lands and premises in the said Indenture of Lease contained and demised as aforesaid, and all the estate, right, title, interest, term of years, property, claim and demand whatsoever of the said party of the first part of, in, to or out of the same, or any part or parcel thereof. 115

TO HAVE AND TO HOLD, the said land and premises to the said party of the second part, his administrators, executors, heirs and assigns, to their own proper use and behoof. 116

The party of the second part accepts the foregoing surrender by the party of the first part and acknowledges unconditional delivery of possesssion of the premises covered by said lease.

IN WITNESS WHEREOF, the said parties have hereunto set their hands and seals the day and year first above written. 117

IRVING TRUST COMPANY
By T. W. EGLY,
Assistant Vice President.

WALTER M. HORT (L. S)

ATTEST:

A. S. MINK
Assistant Secretary.

(Duly acknowledged on December 15, 1933.)

Statement of Evidence.

118

UNITED STATES BOARD OF TAX APPEALS.

Docket No. 89033.

[SAME TITLE.]

Hearing at Room 619, United States Court House, Foley Square, New York, New York, on the 30th day of November, 1938, at 11:00 o'clock, A. M.

The above entitled proceeding came on for hearing on this the 30th day of November, 1938, before the Hon-
119 orable J. E. Murdock, Member of the United States Board of Tax Appeals, at New York, pursuant to notice of hearing heretofore given; whereupon, the following proceedings were had and testimony heard, to-wit:

APPEARANCES:

EDWIN HORT, ESQ. (141 Broadway, New York, New York), appearing on behalf of Petitioner.

F. S. GETTLE, ESQ. (Honorable J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue), appearing on behalf of the Commissioner of Internal Revenue, Re-
120 spondent.

A joint stipulation of facts having been filed, (the material parts thereof being made a part of the printed record herein), the parties thereupon offered the following testimony which has been reduced to narrative form:

EVIDENCE ON BEHALF OF PETITIONER:

Thereupon, the petitioner, to maintain the averments of his petition, introduced the following proof:

MR. THEODORE PELLENS, JR., called as a witness by and on behalf of the petitioner, having been first duly sworn, 121
was examined and testified as follows:

Direct examination by Mr. Edwin Hort:

My address is 40 Harrison Avenue, Montclair, New Jersey. My age is thirty-nine. I am a real estate and property consultant for and in the State of New Jersey. That is my official position. I go around and get the locations and offices for the commissions. At present I am working on the Unemployment Compensation Commission, locating forty-six offices in the State of New Jersey.
I have been in that position since May of this present 122
year. I was at one time employed by the Irving Trust Company. In August, 1933 and before that I was property representative of the Louis K. Liggett Company. I was real estate manager for the Childs Company. I was real estate manager city division Standard Oil. I was property consultant for the Cities Service Company, Henry L. Doherty Companies. My experience in real estate ran for eighteen years.
In connection with my real estate experience I had occasion to appraise real estate and also to rent real estate in the City of New York. I was familiar with the particular district that we have in question this morning, Madison Avenue in the neighborhood of Twenty-eighth 123
Street, New York City, Manhattan, that's why I was hired by the Irving Trust Company. The purpose of my employment by the Irving Trust Company was to try to answer that lease problem on Madison Avenue in conjunction with a few others that they had abandoned the offices and they wished to salvage as much as possible of the rental they were involved in.
I was familiar and am familiar with this particular property, 76 Madison Avenue. I will briefly describe it. It is a fairly modern commercial and office building. It's

124 well constructed. I believe it's fire-proof. Frankly I've forgotten how many floors. It seems to me it's ten or better, and situated at the southwest corner of Madison Avenue and Twenty-eighth Street.

The character of the neighborhood in the year nineteen—when I was employed by the Irving Trust Company, 1933, it had become nondescript, just prior to that time. It had been a very definite commercial center. And all—like all commercial centers they always have a higher value on rental—higher rental value than a nondescript neighborhood which has no personality or definite purpose.

125 Q. Now, the lease that we are speaking of was made in 1927. At that time what was the character of the neighborhood? A. It was definitely a silk center, very high class and demanded good rentals.

I was employed for the purpose among other things of finding a subtenant for these premises for the Irving Trust Company. I made an attempt during approximately August 5 to some time in December. We first circularized every important broker in the city and brought the proposition to their attention, gave them a descriptive letter, and even included pictures in it, and asked their cooperation and outlined very definitely we would do anything in order to consummate a lease for September.

126 I personally canvassed all of the chain agencies, chain stores, and all the better and more prominent business houses that might have an interest in that neighborhood.

I think during that period I have just mentioned I devoted about ninety per cent. of my working time to trying to find a new tenant for those premises. I went through the neighborhood and tried to move people that were located in the neighborhood from their location they did have at that time to this corner. Tried to sell them the advantages of a move. And as, I said before, I spent about ninety per cent. of my time thoroughly canvassing

every possible merchant or business house that might 127
be interested.

A circular letter that was sent out to about forty I believe of the best and most representative real estate dealers and brokers in New York. The paper dated August 3, 1933, which you show me is the circular letter to which I refer. The pictures on the margin of that paper—the bottom picture is the exterior of the building, and the two top pictures are interior shots of the quarters that were under lease to the Irving Trust Company. By "shots" I mean photographs.

Mr. Edwin Hort: I offer it in evidence. 128
The Member: It may be admitted.
The Clerk: Exhibit 1.

(The said letter so offered and received in evidence, was marked Petitioner's Exhibit 1, and made a part of this record a copy of which is attached hereto and made a part hereof.)

By Mr. Edwin Hort:

I don't believe we got any response from the brokers, but through my efforts I got response from the Louis K. Liggett Company, the Liggett Drug Company now. 129
We negotiated some and they thought that they might offer $4,000 a year minimum guarantee and six per cent. of the gross sales, as a lease for the remaining term of years. That proposition was not acceptable to the Irving Trust Company at that time.

When I speak of a percentage of the gross, I mean that they would pay six per cent. of the gross volume that was done in that store. In other words, they'd pay—if they did a hundred thousand dollars worth—had a hundred thousand dollars worth of gross sales, they would

130 pay six per cent. of a hundred thousand dollars as a base rent. If six per cent.——

The Member: What unit of time involved in the hundred thousand dollars gross?

The Witness: Twelve months.

The Member: A year.

By Mr. Edwin Hort:

I was at that time familiar with the average gross receipts of Liggett Company. What made me so familiar was that I had been with them six years. I was able
131 from my experience with the Liggett Company itself to estimate what their gross receipts would probably be for that remaining period of the balance of the lease if they located at this Twenty-eighth Street Corner. At that time I felt that they might do between a hundred and a hundred and fifty thousand a year, so that would make the total yearly rental probably $6,000.

There was another prospect that made an offer to me. There was a ribbon concern I believe on the opposite corner that I tried to interest in and we did get some place, negotiations, but our figure—our talking figures were too far apart. They were thinking in terms of four
132 and five thousand. The bank at that time were thinking in terms of fifteen thousand. I believe also that there was some interest shown by the Manufacturers Trust. But that never did come——

Q. Well, were any figures mentioned by the Manufacturers Trust Company? A. Well, I believe we mentioned—the bank mentioned fifteen thousand. I don't recall now what the Manufacturers Trust Company thought of.

Q. Well, had the Manufacturers Trust Company offered the fifteen thousand that was being— A. Oh, no.

Q. —Was agreeable to the Irving Trust Company, the deal would have been closed, would it not? A. My memory serves me they weren't even considering any amount like that. 133

Q. Now, without going through the entire list, have you at least say one other prospect that you can tell us about? A. Yes, there was a Steuben Restaurants. Their proposition I think if I remember correctly, they were down in the same class, about four or five thousand dollars.

Q. What was the highest offer that you received? A. Well, based on—on—what we thought we could do, the Liggett Company was probably the best offer. 134

The Member: That offer, if I understood it, was to pay $4,000 in any event, and more in case the earnings at six per cent. would make a larger rental?

The Witness: Yes, sir, the sales six per cent. not gain.

The Member: Yes, gross sales.

The Witness: Yes.

By Mr. Edwin Hort:

I reported all this to the Irving Trust Company. I was still with the Irving Trust Company when they cancelled this lease for $140,000 in cash. It was done on my efforts and my recommendation. In procuring that cancellation I worked in conjunction with Mr. Walter Hort, the petitioner, sat in conferences with him, and so forth, on the negotiation of the amounts as to my experience in that neighborhood, I have been concerned in the rental of store properties in or about that neighborhood. 135

In about 1925 and then about 1928. I think it was around 1928 or 1929. Around the period of '25 to '26

136 the Liggett Company had that location in mind, and I canvassed it for—see what was available for them. And then later when I went with the Childs Company they were interested in having some operation over in that section. So at that time I canvassed those sections and became familiar with rental values in that neighborhood.

Q. Now, from the testimony that you have given as to your general experience of rental values in that vicinity, and your particular experience in trying to rent these particular premises, 76 Madison Avenue, are you able to form an opinion as to the rental value on December 1, 1933, of the space in question at 76 Madison Avenue
137 for the period December 1, 1933, and expiring January 31, 1947? A. Well, in my opinion the space in December 1933 was worth approximately a dollar a square foot with the relative fronts and depths and all that thing. This store probably was worth a maximum of five—four to five thousand dollars. As far as the neighborhood has gone, it hasn't improved any up to date and unless something very drastic happens over there it won't improve before 1947, no reason for it to improve. Once a center—once a neighborhood has been a center and then it has been moved away, to my knowledge it has never come back.

Experiences of that kind have occurred right here in the City of New York in the Borough of Manhattan. I
138 can give instances of it. You can take Fourteenth Street, when it was a shopping center, the rentals were certainly definitely much more advantageous that it is today. And then we moved to Twenty-third Street, and Twenty-third Street went down. And it's—those centers have deteriorated tremendously against the days when they were definitely a center, a shopping center. And they have never recovered. They never will.

When I give this figure of 4 to 5 thousand dollars, I understand that that is my opinion as to the rental value

annually from the date of 1933 right down to 1947. Unless as I say, something drastic—some drastic change happens in that neighborhood, there is no reason in the world to expect any more money than five thousand dollars from now to 1947. From the usual and customary experience in the Manhattan area where property has deteriorated for these reasons that I have given, they do not recover. Within any reasonable time; that is right. 139

Mr. Edwin Hort: That is all for this witness.

Cross examination by Mr. Gettle:

As to the size of this building at 76 Madison Avenue. If I remember correctly it was something like fifty-five by a hundred. And I think it's about ten stories or more. I don't remember exactly the height. I was more interested in the ground floor. And that was fifty-five by a hundred, if my memory serves me. The Irving Trust Company occupied the ground floor and part of the basement. 140

Q. This estimate I have just given, four to five thousand dollars, the proportion of the building which that covers is the premises under lease to the Irving Trust Company. First floor and basement. And there were ten or twelve floors above that which the petitioner might have rented? A. I wasn't interested in anything other than what was under lease to the Irving Trust Company. I had no occasion to know anything about what was leased or what was rented above the second floor. I knew it was a ten or twelve story building from observation I assume it was that. 141

Mr. Gettle: That is all.

Mr. Robert Paton Allison, called as a witness by and
142 on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

Direct examination by Mr. Edwin Hort:

I reside at 14 Campion Place, Yonkers, New York. The position I occupy with the Irving Trust Company is manager of real estate and maintenance. I have held that position about fourteen years. I manage the company-owned property, handle all the leases made by the company for premises, any other negotiations that may come up, in connection with those matters. I recall the situation that arose at 76 Madison Avenue in the year
143 1933. I have heard the testimony of Mr. Pellens given this morning in regard to efforts which he made to re-rent the premises in question.

That was done under my supervision. He reported to me as his superior, and conferred with me. I was familiar with the results which he obtained and the offers which he received. In substance, Mr. Pellens' testimony which he gave this morning on that subject coincides with my recollection of what occurred.

Mr. Gettle: May I have this paper marked for identification as Respondent's Exhibit A?

The Member: It may be marked.
144

(The said document was thereupon marked Respondent's Exhibit A, for Identification.)

Cross examination by Mr. Gettle:

Q. Mr. Allison, I hand you a paper. Will you identify that for the Board, please? A. That is my signature. This is an affidavit which was prepared by my office. In my office and signed by me. I've got to think to recall, at whose request this affidavit was prepared, but I will—

as a matter of fact I don't recall. That was 1935. It 145
was prepared relative to the cancellation of this lease which has been discussed here this morning. I have looked at that last paragraph set out therein, to refresh my recollection. My testimony today would be the same as that set out there.

Mr. Gettle: I offer this in evidence, your Honor, Respondent's Exhibit A.

The Member: Is there any objection?

Mr. Edwin Hort: No, I have no objection.

The Member: Received. May I see it?

(The said document, heretofore marked Respond- 146
ent's Exhibit A for Identification, so offered and received in evidence, was marked Respondent's Exhibit A, and made a part of this record a copy of which is attached hereto and made a part hereof.)

Redirect examination by Mr. Edwin Hort:

Q. Mr. Allison, I call your attention to the affidavit in question— Respondent's Exhibit A. The last paragraph— Especially that portion which says: "It was believed that, whereas the trust company's rent under its lease was established at $25,000 per annum for a period of approximately thirteen years, the value in the 147
market was not more than $15,000 per year over the term of the lease and this formed the basis of the agreement to settle the obligation in cash." When you speak of fifteen thousand a year there, was that the amount which the bank was willing to accept? A. We were offering it at that price. I believe the bank might have accepted less than that.

Q. And when you say that, you mean that as a result of the investigations, reports of Mr. Pellens, that your— A. Mr. Pellens and other sources.

148 Q. Mr. Pellens and other sources, that your original thought on fifteen thousand might have been reduced to a smaller sum? A. It might have been reduced to a smaller sum. At that time that was the top figure of valuation which the Irving Trust Company put on future rental of that property.

Recross examination by Mr. Gettle:

Q. Mr. Allison, as you recollect, $15,000 a year which you referred to in that affidavit I showed to you, really reflected the market value of that lease over the entire life of the lease? A. As I—you say market value? Will
149 you repeat what you said, please?

Q. Market value or value in the market as you stated in the affidavit? A. No, I don't think I'd want to say that. It marked our idea of the limit of rent which might be obtained on a lease during that period. There are other hazards—collection, failure of the tenant for one reason or another—I—vacancy during the period, other hazards that might develop.

I am an officer of the Irving Trust Company. The Irving Trust Company with the predecessors before mergers I should say is about eighty years old. It is a very old and established company.

150 Bank, one of the principal banks in New York City. As to the net worth of the company, the Irving Trust Company in 1933 in round figures. I wouldn't care to say. I have no exact knowledge. I do know whether the Irving Trust Company could have paid full $25,000 per year rental under the terms of this lease from its beginning in 1932, February 1, 1932, up to the present date, had the lease not been cancelled. It could have. It was financially able to pay it. In my opinion, the Irving Trust Company could have paid the full $25,000 per year until the term of the lease expired in 1947. I can't speak as

to the future. Up to this time at least they could have. 151
—I believe that at one time we did make a request for a reduction of rent. I don't want to refer to any particular date, because I don't remember. But I think we made an effort to obtain a reduction of rent. There is one point that might be brought out here that hasn't been brought out here, and that is, the office, our bank office was closed in June, 1933. The settlement of the lease didn't occur until December, 1933. We had already closed our office.

Mr. Samuel Lax, called as a witness by and on behalf 152
of the petitioner, having been first duly sworn, was examined and testified as follows:

Direct examination by Mr. Edwin Hort:

I reside at 56 East Eighty-seventh Street, Borough of Manhattan, City of New York. I am a member of the Bar of the State of New York? Practicing in New York City for Oh, twenty—twenty-eight years.

Q. You are familiar with the premises 76 Madison Avenue, Manhattan? A. I am a trustee of those premises, for the certificate holders, that hold investments in the mortgage that formerly covered those premises. As such 153
trustee my agent had occasion to try to negotiate a lease of the ground floor and basement of the premises?

My agents negotiated a lease with Shafer's Pharmacies, Inc. On the ninth day of December, 1936, for the period commencing March 1, 1937, and expiring 28th day of February, 1943. The rental was $4,200 per annum, monthly installments of $350. The place was rented for a drug store, luncheonette, s da fountain, sale of cigars, cigarettes, cosmetics, stationery, candy, and kindred articles. This lease covered approximately two-thirds of the store area, and the balance of the store area was

154 leased—was rented to the Herling Press—Herman Kling is the owner of that; that's trade name, I believe—on the twenty-fourth day of August, 1937, the lease to—rental to commence with the first day of November, 1937. And the lease terminated on the 31st day of January, 1941.

The rental for the period November 1, 1937, to February 1, 1938, was at the rate of $1,200 annually, in payments of a hundred dollars monthly; and for the period from February 1, 1938, to January 31, 1941, the annual rental of $1,800, monthly payments of $150 a month. The occupancy was for a printing and stationery store. I was appointed trustee on the 16th day of June, 1936. I didn't
155 take possession on that date. I took possession a few months later. But at the time I took possession, the entire building was rented with the exception of the store and basement. These leases were negotiated as a result of efforts made by me and my broker. We had attempted to rent out the entire building, which would include the ground floor store and basement.

Q. And were these leases that you finally negotiated the best offers that you could receive for the store and basement? A. Well, best we could get.

Cross examination by Mr. Gettle:

I was appointed trustee on the 16th day of June, 1936.
156 I had nothing to do with the building in 1933, prior to my appointment.

Q. What brought about your appointment as trustee? A. I believe there was what's known as a Shakno reorganization took place, and I was appointed by the Supreme Court as trustee in place of the Mortgage Commission.

I don't know when the mortgagee foreclosed on the building. That happened during the regime of the Mortgage Commission or the superintendent of banks, I don't know which. The foreclosure proceedings were all completed when I came in the picture.

MR. MARK RAFALSKY, called as a witness by and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows: 157

Direct examination by Mr. Edwin Hort:

My residence is 325 West End Avenue, New York City. I am the president of Mark Rafalsky and Company. The business of that company is real estate brokers. They have been in that business about forty years. I have been the head, actively engaged in the executive portions of that business since its formation.

Q. Now, what experience personally have you had in the City of New York in the renting of premises, the appraisal of rental values, and appraisal of property? 158
A. Why, we—I have made a great many sales of real estate, great many leases of real estate, and I have made frequent appraisals of value of real estate, appraisals of rental values, and so forth. I am a member of an organization connected with the real estate industry. I am a member of the Real Estate Board of New York, of which I was a governor for a number of years.

I have not made appraisals for any governmental, city or municipal departments. I have made appraisals under court orders by appointment of Judge of the Supreme Court. I have testified as an expert in cases in the Federal Court here, for example, before Judge Knox, 159
before Judge Cox, and I have had frequent appointments from judges. I am very familiar with this particular premises, 76 Madison Avenue, Manhattan, I am familiar with the building. In 1933 or shortly after 1933, I was requested to obtain a tenant for the banking space, the ground floor and basement of that building. I was engaged to find a tenant by Mr. Hort, Walter Hort.

Now, in connection with that my office and I solicited every line of business that we thought could possibly be located in that property. About 1930, in that

160 period, there were a great many silk people in that district, woolen people, and hat manufacturers. In fact, this entire building I believe was leased at one time to Blum and Koch, whose business was manufacturing of hats, men's hats. We tried to find a tenant for this space, store and basement. And as I said before, we—we canvassed all the various trades that were possible candidates for that kind of space unsuccessfully. We had some ridiculous offers, $2,500 a year, amounted to nothing, you know. We—but we never had an offer that we thought was a sufficient offer to give consideration to.

Q. That was the highest offer that you got, about $2,500?

161 A. Well, I wouldn't call it an offer. We—conversation, we—we—we wouldn't consider it. As to the changes which took place in that neighborhood from about 1932 down to about—from about 1927 down to about 1933, during that five year period, there was an exodus of—of the people who really made up that district, that is the silk and woolen people, and some hat people. And the whole neighborhood deteriorated very very much, and it had for tenants after while some very miscellaneous lot of concerns. There were no trade in that vicinity there, after that period.

Theretofore a trade had been centered there. Before that the silk trade and the woolen trade were important

162 tenants in that district and they were important members of that trade there who brought other people that were in the same line. When they moved away, why the trades moved away, as—as often happens in this city. Since 1933 down to date, there has been no change there. The —if anything it's been a change for the worse, on account of the promiscuous tenancy that was accepted in the district. For instance, the renting of this very store here to cheap drug store and luncheonette room and a printer in the back. That was in line with what was going on in that whole neighborhood. In other words, the property

kept going down and down all the time, and it's just about 163
down to the bottom now.

Comparable situations have occurred in Manhattan regarding changes in the neighborhood. We have had a great deal—for instance, at one time we had Sixth Avenue in New York from Fourteenth Street up to Twenty-third Street was entirely used by fine retail stores like B. Altman and Company and Simpson Crawford and Company, and O'Neill, and Siegel Cooper had a tremendous place at Eighteenth Street and—but there started to be an exodus there. R. H. Macy moved uptown, Altman bought a place up on Fifth Avenue, and then they started to go until Sixth Avenue from Fourteenth Street up to 164
Twenty-third Street became very low rental proposition.

There have been other comparable situations, prominent examples, for instance, Twenty-third Street would be one that at one time we had on that street Stern Brothers had a very important concern. They moved from there up to Forty-second Street. We had Best and Company, Lilliputian Bazaar, which was a landmark in New York and especially on Twenty-third Street. They moved out of there. And then the exodus started and Twenty-third Street became a very mediocre street, continued its decline and it has never recovered.

And likewise we have had other streets that have gone that way. We have had residential sections in New York 165
City that used to be inhabited by the finest people in New York, and finally the sections were encroached by colored people and the march downward started. The usual experience is that where this deterioration occurs there is customarily no recovery. Here at least in this city.

Q. Now, Mr. Rafalsky, we have heard your testimony as to your general experience in renting and in rental values and your particular experience with 76 Madison Avenue. Are you able from those experiences to form

166 an opinion as to the rental value of the store and basement at 76 Madison Avenue on December 1, 1933, for the period from December 1, 1933, expiring January 31, 1947; that is a period of thirteen years and two months?

The Witness: Yes, I am—I have an opinion on that.

By Mr. Edwin Hort:

Q. Will you give us your opinion? A. My opinion today of value of that premise, ground floor and basement, would be not over five thousand or perhaps $5,500 a year.
167 Although at one time I thought the place should rent for more money. But they were not able to get it.

The time that I thought it would rent for more money was well, about that—about that period, 1933—Four or five. At that time I—I thought the rent should be approximately $7,500. I think I made an affidavit to that effect about that period.

Cross examination by Mr. Gettle:

As to approximately how many square feet there were in this property covered by this lease testified to, the lot
168 measures forty-nine feet and five inches on Madison Avenue, and it has a depth of ninety-five feet.

Q. What in your opinion would be the rental value per square foot of that property in 1933? A. Well, approximately a dollar a foot. I am familiar with the rest of the building, that is in size? I examined at one time the entire building.

Q. What would you say is the fair rental in 1933 for the loft portion of the building, the upper stories? A. Well, I think that that period the—I think the lofts were worth from twenty-two, three hundred dollars up to perhaps $4,000, depending on the floor. The building was

not a—in my opinion a very desirable one for renting. 169
The unit is very small. It had but one passenger elevator in it. And it—it wasn't a building that you could rent those lofts at any high prices.

The figures I just quoted were per floor.

WITNESS EXCUSED.

MR. HARRY E. HOOLEY, called as a witness by and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

Direct examination by Mr. Edwin Hort:

My residence, is Morris Turnpike, Short Hills, New 170
Jersey. I'm an accountant, and handle tax matters largely. I am connected with the firm of Puder & Puder of both Newark and New York City, Certified Public Accountants. There is an accepted and customary way in New York City of computing the present value of installment payments in the future covering a number of years; that is to say, what you want is the present cash value of installment payments which will come due over a long period of years if those were discounted and cashed at the present day. There is such a formula. There is such a provision for computing in present day worth of an amount to be received over a period of years. One of the 171
accepted formulas of course is also provided and used in computation in connection with estate tax to the visionary, present worth of money to be received at the end of a certain number of years. Formula as set forth in the regulations is generally followed in such cases for determination of the present value.

That formula is contained in estate tax regulations under Article 10, which sets forth the different years all the way up for ninety-nine years, to obtain the value of an annuity during—the value at the end of a certain

172 given period and also the reversion or present value of one dollar due at the end of any such given period, that formula states a percentage basis for the computation. That percentage is graded for the—all the various different years, as shown in the table, in regulations.

So, by applying the formula which is set forth in that regulation we might compute for instance, in the case which we are now trying, the value on the first day of December, 1933, of $25,000 a year payments coming due for a period of thirteen years and two months thereafter. And that formula could be applied to any similar situation where the present or fixed date value in cash of future payments is to be computed. I have not per-

173 sonally made a computation of the value on December 1, 1933, according to that formula, of payments of $25,000 per annum from the first of December, 1933, for a period of thirteen years and two months thereafter.

I think that I can do that computation within a short period, during recess hour.

Mr. Gettle: I at this time move that all that testimony be stricken as not worth anything in this case, what mathematical computations he might make, want to make. I move that all that testimony be stricken.

174 The Member: Motion denied. As I understand it, what the petitioner is trying to do with this testimony is to show, as of the date the lease was cancelled, what the present worth would be of payments under the lease if all those payments were made in accordance with the terms of the lease.

That is what you are trying to show, is it not?

Mr. Edwin Hort: Exactly, sir.

The Member: That, it seems to me, would be material to the petitioner's theory of this case, going to compute his loss as the difference between

that amount and the amount he got in cancellation of the lease. 175

Mr. Edwin Hort: Correct.

The Member: Of course, I do not know whether you do it by this witness or whether those figures are correct or not. It strikes me, from my knowledge of the formulas, that the risk is involved in all of them. I do not know whether you have proven sufficient data from which a computation could be made or not.

Is the formula you are talking about, Hoskold's formula?

The Witness: Yes, sir. 176

The Member: Well, are there not two factors involved in that? What factors do you propose to use in the computation that you would make?

The Witness: Well, the reversion value as set forth in this table.

The Member: You are just going to take it from the table?

The Witness: Yes, sir, set forth in the regulations, by the method by which the Bureau does make such computations.

The Member: Well, I have no questions to ask about it. I know quite a lot about it but I have not any questions to ask him on it. 177

Mr. Walter M. Hort, called as a witness by and on behalf of the petitioner, having been first duly sworn, was examined and testified as follows:

Direct examination by Mr. Edwin Hort:

I reside at 115 Central Park West, New York City. I am a member of the Bar of the State of New York. I have been admitted to practice twenty-two years. I have

178 maintained my law office at 141 Broadway, Manhattan, New York City.

As to the premises 76 Madison Avenue, Borough of Manhattan, City of New York, I inherited that property from my father.

Cross examination by Mr. Gettle:

I testified a few moments ago that I acquired these various properties on March 7, 1928, by inheritance from my father. That's correct. I lost the property at 76-78 Madison Avenue, through foreclosure. I believe it was in 1935.

179

Mr. Edwin Hort: More or less common knowledge. We all know it was foreclosed. I do not suppose it makes very much difference.

Redirect examination by Mr. Edwin Hort:

As a result of that foreclosure I did not receive any surplus moneys or other moneys above the mortgage. I was sued for deficiency.

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180 Mr. Harry E. Hooley, having heretofore been first duly sworn was recalled to the stand, and was examined and testified as follows:

The Member: I am puzzled, after thinking over what this witness testified to on the stand awhile ago and what he apparently is called back for, to know whether it is a subject of expert testimony. As I understood him, what he is proposing to do now is simply refer to some figures that the Commissioner of Internal Revenue promulgated, some

regulation under the Estate Tax Act; and he proposes to make a computation that ordinary intelligence perhaps could make from those figures. If that is so, I do not think it is a subject for testimony at all, is it? If he can tell me something that I do not know, then of course it is different. 181

Direct examination resumed by Mr. Edwin Hort:

There are no elements or factors in that regulation that affect the computation. You just use present worth of—of one dollar and the number of years for which it has to run in computing the present worth of moneys to be received, and—it's purely a mathematical calculation. 182

The Member: Do you know whether or not in that computation it is assumed that the money will certainly be paid?

The Witness: In the computation being made, it's on the assumption that the money would be received over the remaining life of the lease.

The Member: So that there is no factor in there that covers risks in any way?

The Witness: No, sir.

The Member: All right. Anything further?

Mr. Edwin Hort: No, I think it is a matter of mere mathematics. 183

The Witness: Yes, that's true.

Mr. Edwin Hort: Mr. Rafalsky tells me that he overlooked something about usual brokerage commission on the rerentals, which would be a deduction in the way of loss which I also had overlooked. Take only a moment to testify, I am sure.

MR. MARK RAFALSKY, having heretofore been first duly
184 sworn was recalled to the stand, and was examined and testified as follows:

Direct examination resumed by Mr. Edwin Hort:

There is a well-recognized custom established in New York City for an amount of brokerage commission on the rental of premises. It is established by the Real Estate Board of New York, and is recognized as the base for all charges for commissions. The rate would be computed if it were re-let for thirteen years and two months at least for that term would be one and one-half per cent. of the aggregate gross rental called for in the term. That
185 is the complete brokerage receivable. It's usually paid by the landlord, the owner of the property, in the event of leasing.

Cross examination by Mr. Gettle:

Q. Mr. Rafalsky, is it not a fact that brokers often make special contracts regardless of custom? A. Well, if a member of Real Estate Board departed from the rate, he would be brought before the ethics and commissions committee and expelled from the Board. There may be some shyster brokers who would work for any rate. As far as my office is concerned, in all the years
186 we have been in business we don't—we abide and charge the rate of Real Estate Board of New York, which in this case would be, as I said, one and a half per cent. That's for—that's—that's set forth for leases that are made for a period of two and one-half years or longer and up to twenty-one years.

The Member: The record is closed.

AFTERNOON SESSION.

187

(The Division resumed hearings at 2:00 o'clock P. M., whereupon the following proceedings were had:)

The Member: You may proceed.

Mr. Hort: Mr. Gettle has asked, and I join in the request, to open the case so that we may show that the return was filed with the Collector of Internal Revenue for the Second District.

The Member: The record may show that the parties agree that the petitioner's return for the year 1933 was filed with the Collector of Internal Revenue for the Second District for New York.

Mr. Gettle: That is correct.

188

HEARING CONCLUDED.

The foregoing evidence together with Petitioner's and Respondent's Exhibits is all of the material evidence adduced at the hearing before the Board of Tax Appeals, and the same is approved by the undersigned.

WALTER M. HORT.

EDWIN HORT,
Attorney for Petitioner on Review,
Office and P. O. Address,
141 Broadway,
New York City, New York.

189

Petitioner's Exhibit 1.

190 The foregoing evidence together with Petitioner's and Respondent's Exhibits is all of the material evidence adduced at the hearing before the Board of Tax Appeals, and the same is approved by the undersigned.

(Sgd.) J. P. WENCHEL,
J. P. Wenchel,
Chief Counsel,
Bureau of Internal Revenue,
Attorney for Respondent on Review.

Approved and Ordered Filed this 13 day of Feb., 1940.

191 (Signed) J. E. MURDOCK,
Member.

Petitioner's Exhibit 1.

Attached to Petitioner's Exhibit 1 are photographs of the exterior of the building #76 Madison Avenue, New York City and of the interior depicting the quarters covered by the lease to the Irving Trust Company. By consent of the attorneys for the respective parties and
192 of the Board of Tax Appeals, the printing of such photographs as part of this record has been omitted.

IRVING TRUST COMPANY
One Wall Street
New York

General Office August 3, 1933

Dear Sirs:

The entire store floor and basement in the 50′ x 100′ building on the southwest corner of 28th Street and Madison Avenue are available for sublease.

Petitioner's Exhibit 1.

The space is fully equipped for the conduct of a complete banking and safe deposit business, and can be acquired at a reasonable rate on a lease running to 1947. 193

THIS OFFERS AN EXCELLENT OPPORTUNITY FOR SOME FINANCIAL INSTITUTION, EITHER TO OPEN A NEW BRANCH AT VERY MODERATE EXPENSE OR TO REDUCE THE OVERHEAD OF A NEARBY OFFICE THROUGH MOVING IT INTO THESE READY MADE QUARTERS AT A LOW RENTAL.

Although the premises in their present condition best meet the requirements of a financial institution, we will be pleased to consider a reasonable offer from any desireable and financially responsible tenant. 194

Rental—$15,000., or thereabouts—possession at once.

If you have an interested prospect, we will be pleased to provide you with further information, arrange for an inspection of the premises and cooperate in every way with your representative.

Very truly yours,

IRVING TRUST COMPANY
By A. B. PARKER

195

Respondent's Exhibit A.

R. P. ALLISON, being duly sworn, deposes and says that he is over the age of twenty-one and resides at 14 Campion Place, Yonkers, N. Y.; that he is Manager of Real Estate and Maintenance for Irving Trust Company; further, that on or about June 10th, 1933, the business of the Irving Trust Company's banking office then located at Twenty-eighth Street and Madison Avenue (76 Madison Avenue), was discontinued and its business consolidated

196 with that of the Fifth Avenue Office located in the Empire State Building at 350 Fifth Avenue; and that thereafter extensive efforts were made to dispose of the space thus vacated, by sublease and that said efforts included:

—the hiring of a solicitor who devoted his entire time in an effort to dispose of this location and one or two other less important locations, being employed during the period, August 4th to December 31st inclusive, 1933.

—solicitation of the aid of forty or more prominent real estate brokers.

197 During the period the premises were offered, preliminary negotiations were entered into with Mr. B. R. Harriman, representing Steuben Taverns Corporation, Manufacturers Trust Company and other interested concerns, but no favorable progress was made and no lease concluded. None of the efforts referred to were productive of definite results.

On December 15th, 1933, a cancellation of the lease was effected in consideration of cash payment of $140,000. In agreeing to pay this amount for cancellation, it was believed that, whereas the Trust Company's rent under its lease was established at $25,000. per annum for a period of approximately thirteen years, the value in the market
198 was not more than $15,000. per year over the term of the lease and this formed the basis of the agreement to settle the obligation in cash.

R. P. ALLISON

Subscribed and sworn to before me
this 2d day of April, 1935.

M. PAUL,
Notary Public
Com. expires Mar. 30, 1936.

Praecipe for Record.

199

Filed Feb. 9, 1940

IN THE UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE SECOND CIRCUIT

B. T. A. Docket No. 89033.

WALTER M. HORT,
Petitioner on Review,

v.

200

COMMISSIONER OF INTERNAL REVENUE,
Respondent on Review.

To the Clerk of the United States Board of Tax Appeals:

Please prepare a transcript of record in this cause and transmit the same to the Clerk of the United States Circuit Court of Appeals for the Second Circuit, and include in such transcript copies, duly certified as correct, of the following documents:

1. Docket entries of the proceedings before the Board.
2. Pleadings before the Board, 201
   (a) Petition filed with Board, including annexed copy of deficiency notice and statement attached thereto, but *omitting* Paragraphs 4(a) and 5-A, B, C, D, E, F, G, H, I, and J of Petition.
   (b) Answer, *omitting* Paragraphs 5-A to J, inclusive.
3. Findings of fact and opinion of the Board of Tax Appeals, promulgated May 19, 1939.

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4. Decision of the Board of Tax Appeals entered September 15, 1939.

5. Petition for review and assignments of error, together with proof of service of a copy thereof.

6. Stipulation of Facts filed November 30, 1938, together with Exhibit No. 5, *omitting* Paragraphs 1, 2, 3, 4, 5, 6, 7, and 8 of the stipulation.

7. Statement of evidence as settled, including Exhibits, Petitioner's Exhibit No. 1 and Respondent's Exhibit A.

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8. This praecipe for transcript to be prepared, certified and transmitted as required by law and the rules of the United States Circuit Court of Appeals for the Second Circuit.

9. Orders enlarging time for the preparation of the evidence and for the transmission and delivery of the record (not included in record).

WALTER M. HORT.

EDWIN HORT,
Attorney for Petitioner on Review,
Office & P. O. Address,
141 Broadway,
Borough of Manhattan,
City of New York.

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Service of a copy of the within Praecipe is hereby admitted this 9th day of February, 1940, and praecipe agreed to.

J. P. WENCHEL,
J. P. Wenchel,
Chief Counsel,
Bureau of Internal Revenue,
Attorney for Respondent on Review.

Clerk's Certificate.

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UNITED STATES BOARD OF TAX APPEALS

Washington

Docket No. 89033

WALTER M. HORT,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

206

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages 1 to 66, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 14th day of February, 1940.

207

B. D. GAMBLE,
Clerk,
United States Board of Tax Appeals.

(Seal)

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Opinion, Circuit Court of Appeals.

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UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE SECOND CIRCUIT.

No. 299—October Term, 1939.

(Argued May 9, 1940 Decided May 27, 1940.)

WALTER M. HORT,

Petitioner,

v.

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GUY T. HELVERING, Commissioner of Internal Revenue,

Respondent.

Appeal from an order of the Board of Tax Appeals assessing against the petitioner a deficiency in income tax for the year 1933.

Before—L. HAND, CHASE and PATTERSON, *Circuit Judges.*

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EDWIN HORT, for the petitioner.

MORTON K. ROTHSCHILD, for the respondent.

Per Curiam:

Order affirmed on the authority of *Warren Service Corp.* v. *Helvering,* 110 F. (2d)

Order for Mandate.

214

UNITED STATES CIRCUIT COURT OF APPEALS,

SECOND CIRCUIT.

At a Stated Term of the United States Circuit Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 12th day of June one thousand nine hundred and forty.

Present—HON. LEARNED HAND,
HON. HARRIE B. CHASE,
HON. ROBERT P. PATTERSON,
Circuit Judges.

215

WALTER M. HORT,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Appeal from the United States Board of Tax Appeals.

216 This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order of said United States Board of Tax Appeals be and it hereby is affirmed.

It is further ordered that a Mandate issue to the said Board in accordance with this decree.

D. E. ROBERTS,
Clerk.

(Back)

217

UNITED STATES CIRCUIT COURT OF APPEALS,

SECOND CIRCUIT.

WALTER M. HORT,

v.

COMMISSIONER OF INT. REVENUE.

ORDER FOR MANDATE.

218

UNITED STATES CIRCUIT COURT
OF APPEALS

SECOND CIRCUIT

Filed Jun 12, 1940

D. E. ROBERTS, Clerk.

219

Clerk's Certificate.

220

UNITED STATES OF AMERICA,

SOUTHERN DISTRICT OF NEW YORK.

I, D. E. ROBERTS, Clerk of the United States Circuit Court of Appeals for the Second Circuit, do hereby certify that the foregoing pages, numbered from 1 to 72, inclusive, contain a true and complete transcript of the record and proceedings had in said Court, in the case of

WALTER M. HORT,

Petitioner,

221

—against—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

as the same remain of record and on file in my office.

IN TESTIMONY WHEREOF, I have caused the seal of the said Court to be hereunto affixed, at the City of New York, in the Southern District of New York, in the Second Circuit, this ninth day of October, in the year of our Lord one thousand nine hundred and forty, and of the Independence of the said United States the one hundred and sixty-fifth.

222

D. E. ROBERTS,
Clerk.

(Seal)

[fol. 75] [Stamp:] Office of the Clerk, Supreme Court U. S. Aug. 27, 1940

SUPREME COURT OF THE UNITED STATES

WALTER M. HORT, Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE

ORDER EXTENDING TIME WITHIN WHICH TO APPLY FOR WRIT OF CERTIORARI

On consideration of the application of counsel for Walter M. Hort, petitioner in the above entitled cause, and good cause therefore having been shown, it is now hereby ordered that the time within which a petition for a Writ of Certiorari may be filed herein be, and the same is hereby extended for a period of sixty days from this date.

Dated August 24, 1940.

Stanley Reed, Associate Justice of the Supreme Court of the United States.

[fol. 76] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed November 25, 1940

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted, limited to the first question presented by the petition for the writ.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

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FILED
OCT 18 1940
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 517

WALTER M. HORT,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

WALTER J. ROSSTON,
Counsel for Petitioner.

EDWIN HORT,
Of Counsel.

THE COURT PRESS, N. Y. C.

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Section 240(a) 2

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

No.

WALTER M. HORT,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for Writ of Certiorari to the Circuit Court of Appeals for the Second Circuit.

Petitioner respectfully prays that a writ of certiorari issue to review the decision of the Circuit Court of Appeals for the Second Circuit, affirming a determination of the United States Board of Tax Appeals assessing an income tax deficiency of $38,070.71 in the personal income tax of the petitioner.

OPINIONS BELOW.

The opinion of the United States Board of Tax Appeals is reported in 39 B. T. A. 922. The opinion of the Circuit Court of Appeals is unreported and is as follows, "affirmed on authority of *Warren Service Corp.* v. *Helvering,* 110 Fed. (2) 723".

JURISDICTION.

The decision of the Circuit Court of Appeals was entered on the 27th day of May, 1940. The peti-

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(Figures in parentheses refer to pages of record in Circuit Court of Appeals.)

tioner's time within which to file this petition was extended sixty days by an order of this Court made on August 24th, 1940. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925.

Questions Presented.

First: In computing net gain or loss for income tax purposes can a taxpayer upon the cancellation of a long term lease of great value to him as the lessor, offset the loss of the value of the lease cancelled against the consideration received by him for the cancellation. (In this case the Circuit Court of Appeals, Second Circuit, has held that such offset is improper, the Circuit Court of Appeals, Seventh Circuit, to the contrary, notwithstanding.)

Second: Where a taxpayer's petition for review by the Board of Tax Appeals sets forth two theories of tax computation, and the Circuit Court of Appeals disallows the theory urged by the petitioner, has not the Circuit Court of Appeals the power to remand the case to the United States Board of Tax Appeals for a re-hearing to permit the taxpayer to establish the other theory which in good faith and for good cause he did not develop before the Board of Tax Appeals upon the original hearing, especially if grave injustice may be done if such re-hearing is not allowed?

Statement of Facts.

On March 7, 1928 the petitioner inherited from his father the premises 76 Madison Avenue, New York City, a business building, the ground floor and base-

ment of which, at that time, was occupied for banking purposes by Irving Trust Company of New York, a very substantial and financially responsible banking institution. The Bank was a tenant of said premises under a lease which was to expire on January 31, 1932 (Stipulation of Facts, p. 35). In order to assure that at the expiration of its lease the Bank could continue in uninterrupted possession of the demised premises, the Bank entered into a lease of the same premises with petitioner's father in 1927 for a term of fifteen years, to commence February 1st, 1932 upon the expiration of the prior lease. The rental under the new lease was $25,000 per annum (Stipulation of Facts, p. 35).

In December 1933, at a time when the unexpired term of said new lease was thirteen years and two months, the petitioner as landlord and the Bank as tenant, by mutual consent, cancelled said new lease thus entirely releasing the Bank as tenant from any further obligation to pay rent for the unexpired term (Petitioner's Exhibit 5, Annexed to Stipulation of Facts, p. 38). The amount of such rental for the unexpired term, at the rate of $25,000 per annum, totaled $329,166.67 to which sum the petitioner, by such cancellation, relinquished all claim.

As a consideration for such cancellation, the Bank paid to the petitioner at the time of the cancellation $140,000 in cash (p. 38).

The full amount of this $140,000 the Commissioner contends is income for the calendar year 1933, in which year it was received by the petitioner.

The petitioner contends, upon the facts appearing uncontradicted in the record, that instead of income or gain of any kind to the petitioner, the transaction resulted in an actual loss to the petitioner in a substantial sum; or, in any event, that if the transaction

did not actually result in a loss it at least resulted in no income or gain of any kind to the petitioner.

The question involved is purely one of law, as the facts upon which the petitioner bases his claim of loss are wholly uncontradicted.

The petitioner could not have negotiated another lease, with a responsible party, for the unexpired term of the cancelled lease, for a rental equal to the rental provided for the unexpired term of the cancelled lease.

The only new leases which could be negotiated were for a rental so small that the amount of such re-rentals obtainable for the full unexpired term of the cancelled lease, plus the $140,000 received upon the cancellation, was less than the original rental of $25,000 per annum (pp. 46-47, 50, 51, 52, 56). The best offers actually obtainable, as well as expert opinions as to the rental value of the premises for the whole unexpired term, and the rentals actually obtained on the re-rental of the premises, covering the period of five years after the cancellation (pp. 51-52) clearly proved this. The respondent offered no proof to the contrary and apparently rested upon the question of law raised by him.

It appeared that subsequent to the cancellation of the lease the petitioner lost the real property by foreclosure of the mortgage. That there was no surplus money (p. 60), thus establishing that the possibility of recoupment of his loss by the petitioner's re-renting of the premises was destroyed.

It further appeared that the lease in question was in existence at the time the petitioner inherited the property and that at that time the market value of the property as it then existed, with said lease thereon, was appraised for estate tax purposes, and that such

taxes were computed and paid upon such appraisal of $650,000 (p. 36).

It further appeared that following the cancellation which occurred in December 1933 a receiver in a foreclosure action took possession of the property about three months thereafter, in March 1934, and that the petitioner never again had possession of the premises.

The petition for review filed with the United States Board of Tax Appeals set forth two grounds for a reversal of the determination of the Commissioner of Internal Revenue:

First, the refusal of the Commissioner to allow as an offset against the cash consideration received on the cancellation of the lease the value of the lease cancelled, measured by the difference between the rent reserved in the lease for the unexpired term of the lease, and the actual rental obtainable for such unexpired term, and

Second, the right of the petitioner to offset against such cash receipt the loss of the value of the real property itself through mortgage foreclosure closely following the cancellation, which foreclosure was caused by the failure of the income of the property, because of the cancellation, to pay the expenses of the operation of the real property and the mortgage obligations.

Upon the hearing before the Board of Tax Appeals, only the grounds referred to under First were proven; the grounds under Second were proven in part to the extent that it was shown that the real property was lost by foreclosure, as alleged in the petition, but the cause of the loss, that is, the in-

sufficiency of the income, was not attempted to be proven. The reason for this was that the petitioner relied upon the sufficiency of ground First, all of the proven facts of which were uncontradicted by the respondent, and the decision of the Circuit Court of Appeals, Seventh Circuit, in the case of *Commissioner of Internal Revenue* v. *Langwell Real Estate Corporation,* 47 Fed. (2) 841, which was apparently the sole and controlling authority upholding the sufficiency of ground First.

The Board of Tax Appeals in its decision, however, did not follow the *Langwell* case, and upon appeal by the petitioner to the Circuit Court of Appeals, Second Circuit, the determination of the Board was affirmed, thus creating a conflict between the decisions of the Second and the Seventh Circuits.

Upon the argument of the appeal a discussion of ground Second was had and it appeared that upon a re-hearing the petitioner might prove, if given the opportunity, that the loss of the property through foreclosure occurred during the taxable year of 1933 because of the cancellation of the lease in that year, and that the loss of the property through foreclosure in 1935, when the foreclosure sale finally occurred, was not the sole criterion of when the loss occurred. That there might be good grounds in justice and equity for allowing the loss of the property to be deducted during the year of the cancellation as an offset to the cash consideration received for the cancellation, but that the Circuit Court of Appeals might not have the power to remand for a re-hearing. Briefs were requested by the Circuit Court of Appeals on the question of the Court's power to remand, and such briefs were submitted but the Court of Appeals affirmed the Board of Tax Appeals without remanding.

Specification of Errors.

The Circuit Court of Appeals erred:

(1) In affirming the decision of the United States Board of Tax Appeals.

(2) In refusing to permit the petitioner to deduct or offset from said $140,000. the amount of loss sustained by him arising from the cancellation of the lease.

(3) In failing to remand the case to the United States Board of Tax Appeals for a re-hearing upon the alternate theory set forth in the petition of the petitioner to the United States Board of Tax Appeals, to wit, that the petitioner suffered the loss of his equity in the property by the foreclosure of a mortgage upon the property, which foreclosure resulted from the cancellation of the lease, and that the petitioner be permitted to offset such loss against the amount of the consideration received by him for the cancellation of the lease.

Reasons for Granting the Writ.

1. The Circuit Court of Appeals of the Second Circuit has rendered a decision in this case in apparent conflict with the decision of the Circuit Court of Appeals, Seventh Circuit, on the same matter, to wit, *Commissioner of Internal Revenue* v. *Langwell Real Estate Corp.*, 47 Fed. (2) 841. Said conflicting decisions were rendered upon the point as to whether or not for income tax purposes, a taxpayer upon the cancellation of a lease under which he is the lessor, can offset the value of the lease cancelled against the consideration received by him for the cancellation. The Circuit Court of Appeals, Second Circuit, in this case has held that such a deduction may not

be made. The Circuit Court of Appeals, Seventh Circuit, has held in a similar case that such a deduction may be made.

That the decisions of the Courts of Appeal of these two Circuits are in conflict appears from the decision of the Second Circuit Court in this case which simply states that there is an affirmance upon the authority of its own decision rendered shortly prior in the case of *Warren Service Corp.* v. *Commissioner,* 110 Fed. (2) 723. In the *Warren Service Corp.* case, which also involved the right of offset of the value of a cancelled lease against the consideration received for the cancellation, the Appeal Court, Second Circuit, stated in its opinion "If the case of *Commissioner* v. *Langwell Real Estate Corp.,* 47 Fed. (2) 841 (C. C. A. 7) is to be read as supporting the taxpayer's contention we must respectfully decline to follow it, as did the Board."

There is thus presented an express refusal to follow an earlier decision on the same matter by an Appeal Court of another Circuit and a clear conflict between the Appeal Courts of the two Circuits results.

2. The Circuit Court of Appeals, Second Circuit, has apparently refused to remand this case to the United States Board of Tax Appeals for a re-hearing, which might avoid a grave injustice to the taxpayer and has apparently refused to remand upon the ground that it lacks the power.

Upon this point there appears also to be a conflict of decisions between the Circuit Court of Appeals, Second Circuit, in this case, and the Circuit Court of Appeals of the Fifth, Seventh and the Ninth Circuits, all of which latter Courts have remanded cases to the United States Board of Tax Appeals for a re-hearing when justice required.

The decision of the Circuit Court of Appeals, Second Circuit, in this case, is in such form that it is not clear whether the Court refused to remand because of lack of power or because this was not a proper case to be remanded; however, the supplemental briefs which were filed were requested by the Court, upon the argument of the appeal, upon the question of the power of the Court to remand.

3. If there be any doubt as to the power of a Circuit Court of Appeals to remand a case to the United States Board of Tax Appeals for a re-hearing when justice requires it, then this case presents for review an important question of federal law which has not been but should be settled by this Court.

4. If a Circuit Court of Appeals has power to remand a case to the United States Board of Tax Appeals for a re-hearing where justice requires, is not the refusal to remand in this case a miscarriage of justice where the taxpayer has not fully presented his case to the United States Board of Tax Appeals because of proper reliance in good faith upon a Circuit Court of Appeals decision which at the time was the controlling authority of the case?

Conclusion.

For the foregoing reasons, it is respectfully submitted that this petition for a writ of certiorari should be granted.

Respectfully submitted,

Walter J. Rosston,
Counsel for Petitioner.

Edwin Hort,
Of Counsel.

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BRIEF IN SUPPORT OF PETITION.

POINT I.

There is clearly a conflict in the decisions of the Circuit Courts of Appeal on the question of the right of a taxpayer, for income tax purposes, to deduct the value of a lease lost through cancellation from the amount of consideration received by the taxpayer for the cancellation.

The identical question decided in the case at bar arose in 1931 in the Circuit Court of Appeals, Seventh Circuit,

> *Commissioner of Internal Revenue* v. *Langwell Real Estate Corporation,* 47 Fed. (2) 841 (Seventh Circuit)

and apparently the decision in that case was the highest authority on the point until the Circuit Court of Appeals, Second Circuit in the case at bar declined to follow it in *Warren Service Corp.* v. *Commissioner,* 110 Fed. (2) 723.

In the *Langwell* case, *supra,* a long term lease was cancelled by mutual consent of the lessee and of the taxpayer who was the owner of the premises by deed from the original lessor. (We shall refer to the transferee as the lessor.) At the time of the cancellation, the lessor held $50,000 of the lessee as security for the faithful performance by the lessee of the terms of the lease, said sum to be returned to the lessee at the expiration of the term, with interest. As the consideration for the cancellation it was agreed between the lessor and lessee, that the lessor keep the $50,000.

It was held by the Circuit Court of Appeals that the lessor was enriched in said sum, unless it appeared that the lessor "suffered a loss by reason of the termination of the lease." The sole test laid down by the Court for determining whether a loss was suffered is in the words of the Court:

> "If respondent could have readily negotiated another lease with a responsible party, as favorable as the lease which was cancelled, it suffered no loss. On the other hand, if it could not have negotiated such a lease, then it suffered a loss. The amount of such loss, if any, was the legitimate subject of proof. The actual execution of a new lease was not necessary to the determination of this issue. The rental value of such property could be shown by oral testimony."

The *Langwell* case is factually similar to the case on appeal so far as concerns the cancellation of the lease and the consideration therefor.

In the *Langwell* case the matter was sent back by the Circuit Court to the Board of Tax Appeals for rehearing on the issue of loss. The Board found on the rehearing that the lessor had not suffered any loss on the evidence presented. (30 B. T. A. 145.)

No attempt will be made in this brief to review the evidence submitted on the hearing on the present appeal before the Tax Board as no attempt was made by the respondent to contradict the convincing evidence presented by the petitioner, that the premises could not be as favorably relet after the cancellation as they had been under the terms of the cancelled lease. The respondent has not questioned the sufficiency of this proof, but apparently claims that the principle laid down by the *Langwell* decision is erroneous and should not be followed.

The petitioner rested upon the precedent of the *Langwell* case.

In the *Warren Service Corporation* case, referred to above there was likewise a cancellation of a long term lease by mutual consent of the owner and the lessee for a large cash consideration or the equivalent of cash paid by the lessee to the owner. Proof was given that the premises could not be relet upon as favorable terms as the former lease.

In deciding that there could be no offset in that case and that the decision in the *Langwell* case *supra* should not be followed, the Court stated in its opinion:

> "Assuming arguendo that this be true, the taxpayer contends that it sustained a loss by reason of the cancellation of the lease which more than offsets such income. It urges that it surrendered a contractual right to receive annual rentals far in excess of any sum for which it has been able to relet the premises. But this does not establish a deductible loss in 1933; it shows merely a diminution of expected income during that year and subsequent years. The taxpayer has sustained no loss of property in the income-tax sense. The land and building were and still are owned by the taxpayer and they have produced income. The difference between the income actually received and the income the taxpayer had expected to receive is not a deductible loss. What has been lost is merely prospective income. See *Josey* v. *Commissioner,* 104 F. (2d) 453, 455 (C. C. A. 10). If the case of *Commissioner* v. *Langwell Real Estate Corp.,* 47 F. (2d) 841 (C. C. A. 7) is to be read as supporting the taxpayer's contention, we must respectfully decline to follow it, as did the Board."

The *Josey* case mentioned in the foregoing opinion, although presenting a somewhat similar situation, does not actually decide the point in question, partly because there was lack of proof of all the elements necessary to claim a deduction and further, because the taxpayer had apparently claimed and actually been allowed a deduction in the nature of amortization over the balance of the term of the lease and was, therefore, claiming a double deduction. Furthermore, the decision does not even mention the *Langwell* case *supra.*

Insofar as the fact that title to the real property was still in the taxpayer may have been a reason for the refusal of the Second Circuit Court in the *Warren Service Corporation* case *supra,* to follow the *Langwell* rule, it should be noted that in the *Langwell* case it did not appear that the taxpayer had lost the real property by sale or otherwise. Apparently the Circuit Court of Appeals in the *Langwell* case did not consider this of any moment in reaching its decision. However, in the case at bar it should be noted that the taxpayer did lose the real property by foreclosure so that all possibility of recoupment was lost. Thus the case at bar presents a much stronger case for the taxpayer than the *Warren Service Corp.* case *supra.*

Between the time of the cancellation of the lease and the loss of the real property by foreclosure the record shows that the demised premises were not rerented. The Receiver in the foreclosure proceedings was appointed on March 16, 1934. The foreclosure sale was in 1935 (p. 60). The formerly demised premises were not relet even in part until March 1st, 1937, by the successor in title (p. 51).

Thus all speculation as to the possibility of recoupment of the taxpayer is wholly avoided. There was no recoupment and none is possible.

It has been recently held by the Circuit Court of Appeals that the fact that the taxpayer continues to hold title to real property does not necessarily deprive him of the right to claim that he has lost the value of the property.

Rhodes v. *Commissioner of Internal Revenue*, 100 Fed. (2nd) 966, Sixth Circuit.

It clearly appears that there is a conflict in the decisions of the Circuit Courts of Appeal on the subject in question which requires review and determination by this Court.

The question of the tax rule to be applied in cases of the cancellation of valuable leases is arising more and more frequently. The amount of taxes involved in such controversies is frequently substantial and a fixed ruling upon the subject appears to be necessary in order to remove the uncertainty as to whether or not such transactions are subject to taxation for the entire amount received without the right to deduct the amount of the concurrent loss.

POINT II.

Even if the Circuit Court of Appeals in this case properly affirmed the decision of the United States Board of Tax Appeals, the case should have been remanded for a rehearing by the Board to take proof on the alternate theory of the case in order to avoid an injustice, and clearly the Court of Appeals was in error if it held that it had no power to remand, and any such decision of lack of power is in conflict with the decisions of Courts of Appeal in other Circuits.

It is pointed out in the petition herein that there was an alternate theory of tax computation claimed by the taxpayer on his petition for review by the Tax Board but that no attempt was made to sustain the theory before the Tax Board. The theory based upon the *Langwell* case *supra* appeared sound and the facts were not disputed.

It is also pointed out in the petition herein that upon the argument of the appeal before the Circuit Court of Appeals the question of the power of the Circuit Court to remand the case to the Tax Board to take proof upon the alternate theory was raised, and supplemental briefs were requested by the Court on this point, and were submitted.

The affirmance by the Circuit Court without mention of remand would indicate that either the Circuit Court determined that it had not the power to remand, or that this was not a proper case to be remanded. It would appear that whichever determination was reached the decision is one which should be reviewed by this Court for the following reason:

If the Circuit Court decided that it had no power to remand then such decision is in conflict with de-

cisions rendered in the Fifth, Seventh and Ninth Circuits in the following cases in which the power to remand was exercised to take additional proof in order that a full and fair determination could be made of the entire matter.

In the Seventh Circuit the *Langwell* case *supra* was remanded for the purpose of taking proof on the question of the difference between the rental provided by the term of the cancelled lease for the remainder of the original term and the re-rental value of the premises for a like period in order to permit an offset similar to the one claimed in the case at bar.

In

Alger-Sullivan Lumber Co. v. *Commissioner,* 57 Fed. (2) 3 (Fifth Circuit)

the following was decided:

> "The judgment of the Board is reversed and the cause is remanded for further proceedings not inconsistent with this opinion."

It would further appear that without actually reversing the Board it is proper to remand the case, with instructions such as the following given in the case of

Belridge Oil Co. v. *Helvering,* 69 Fed. (2) 432 (Ninth Circuit).

> "The case is remanded to the Board of Tax Appeals with instructions to specifically find the actual value of the option in question."

In

Eaton v. *Commissioner,* 81 Fed. (2) 332 (Ninth Circuit)

the case was "remanded to the Board of Tax Appeals for a specific finding on the question * * *"

In

Fulton Oil Co. v. *Commissioner*, 81 Fed. (2) 330 (Ninth Circuit)

the Circuit Court found that a matter which was not raised before the Board of Tax Appeals should be the subject of a re-hearing in the following words:

> "We must remand the case to the Board of Tax Appeals for a finding as to whether there was a sale and consequent deductible loss." (Citing cases.)

This case may well be considered one in which there is an absence of a finding on a question which may be material to a full and just disposition of the case, to wit, the absence of any finding upon the issue raised by paragraph 5 W of the petition (fol. 27) that the cancellation of the lease in question was the direct and immediate cause of the foreclosure and loss of the petitioner's equity in the property, or it may be considered that there is an incomplete and unsatisfactory finding on this subject, to wit, the finding of the Board (at fol. 64) reading as follows:

> "The petitioner lost the property through foreclosure in 1935."

as well as the conclusion reached by the Board in its opinion apparently based upon such finding, reading as follows (fol. 73):

> "But he did not dispose of that property, and he sustained no loss in regard to it. Thus, even if on some theory the petitioner might be entitled to a loss, nevertheless, he has failed to prove that in fact any loss was sustained."

The petitioner should be given an opportunity to prove any loss of equity in the property itself which he may have suffered by reason of the foreclosure of the mortgage resulting from the cancellation of the lease, as alleged in the petition to the Tax Board.

CONCLUSION.

Because of the apparent conflict in the decisions of the Second and Seventh Circuit Courts of Appeal on the important question of the right of a taxpayer to offset the loss sustained by the cancellation of a valuable lease against the consideration received by him for the cancellation, this case should be reviewed by this Court. Furthermore, if the Langwell decision in the Seventh Circuit is no longer to be considered as good law, then justice requires that the case be remanded to the United States Board of Tax Appeals for a re-hearing on the alternate theory of loss pleaded in the taxpayer petition to the Board; and if there is any doubt as to the power of a Circuit Court of Appeals to remand a case to the Tax Board, then a grave question of the power of the Circuit Courts of Appeal arises which should be reviewed by this Court.

Respectfully submitted,

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IN THE

Supreme Court of the United States

October Term, 1940—#517.

WALTER M. HORT,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF FOR PETITIONER.

WALTER J. ROSSTON,
EDWIN HORT,
Attorneys for Petitioner.

THE COURT PRESS, N. Y. C.

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IN THE

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COMMISSIONER OF INTERNAL REVENUE,

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BRIEF FOR PETITIONER.

Opinions Below.

The opinion of the Board of Tax Appeals (R. 19-26) is reported in 39 B. T. A. 922. The opinion of the Circuit Court of Appeals is reported in 112 Fed. (2) 167 and was *per curiam* as follows: "Order affirmed on the authority of *Warren Service Corporation* versus *Helvering,* 110 Fed. (2) 273."

Jurisdiction.

This appeal involves income taxes of the petitioner for the year 1933 in the amount of $38,070.71. The judgment of the Circuit Court of Appeals, Second Circuit was entered May 27th, 1940. Jurisdiction is conferred by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

This cause comes here by virtue of a writ of certiorari granted on November 25th, 1940.

Statute Involved.

Revenue Act of 1932, c. 209, 47 Stat. 169:

"SEC. 22. GROSS INCOME.

(a) *General Definition.* 'Gross income' includes gains, profits, and income derived from * * * dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * * * *

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * * * *

(e) *Losses by Individuals.* Subject to the limitations provided in subsection (r) of this section, in the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

* * * * * * *

'(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or'

* * * * * * *

SEC. 101. CAPITAL NET GAINS AND LOSSES.

* * * * * * *

(c) *Definitions.* For the purpose of this title—

(1) 'Capital gain' means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921."

Statement of Facts.

On March 7, 1928 the petitioner inherited from his father who was the owner in fee thereof the premises 76 Madison Avenue, New York City, a business building, the ground floor and basement of which, at that time, was occupied for banking purposes by Irving Trust Company of New York, a very substantial and financially responsible banking institution. The Bank was a tenant of said premises under a lease which was to expire on January 31, 1932 (Stipulation of Facts, p. 35). In order to assure that at the expiration of its lease the Bank could continue in uninterrupted possession of the demised premises, the Bank entered into a further lease of the premises with petitioner's father in 1927 for a term of fifteen years, to commence February 1st, 1932 upon the expiration of the prior lease. The rental under the new lease was $25,000 per annum (Stipulation of Facts, p. 35).

In December 1933, as the result of negotiations initiated by the Bank and at a time when the unexpired term of said new lease was thirteen years and two months, the petitioner as landlord and the Bank as tenant, by mutual consent, cancelled said new lease thus entirely releasing the Bank as tenant from any further obligation to pay rent for the unexpired term (Petitioner's Exhibit 5, Annexed to Stipulation of Facts, p. 38). The amount of such rental for the unexpired term, at the rate of $25,000 per annum, totaled $329,166.67 to which sum the petitioner, by such cancellation, relinquished all claim.

As a consideration for such cancellation, the Bank

(Figures in parentheses refer to pages of record.)

paid to the petitioner at the time of the cancellation $140,000 in cash (p. 38).

The full amount of this $140,000 the Commissioner contends is income for the calendar year 1933, in which year it was received by the petitioner.

The petitioner contends, upon the facts appearing uncontradicted in the record, that instead of income or gain of any kind to the petitioner, the transaction resulted in an actual loss to the petitioner in a substantial sum; or, in any event, that if the transaction did not actually result in a loss it at least resulted in no income or gain of any kind to the petitioner.

The question involved is purely one of law, as the facts upon which the petitioner bases his claim of loss are wholly uncontradicted.

The petitioner could not have negotiated another lease, with a responsible party, for the unexpired term of the cancelled lease, for a rental equal to the rental provided for the unexpired term of the cancelled lease (R. 46, 47, 50, 51, 52 and 56). The respondent offered no proof to the contrary.

As a matter of fact, the formerly demised premises remained vacant subsequent to the cancellation of the lease and were still vacant when about three months later in March 1934 as a result of mortgage foreclosure proceedings, a receiver took possession of the property (R. 9). In fact the premises were not relet even in part until long subsequent to the foreclosure sale. In 1937 the successors in title on such sale relet part of the premises (R. 51).

It was thus established that the possibility of recoupment of his loss by the petitioner's re-renting of the premises was destroyed. There was no surplus moneys as a result of the foreclosure (R. 60).

It further appeared that the lease in question was

in existence at the time the petitioner inherited the property and that at that time the market value of the property as it then existed with said lease thereon was appraised for estate tax purposes, and that such taxes were computed and paid upon such appraisal of $650,000 (p. 36).

Question Presented.

In order to ascertain whether a transaction involving a cancellation of a lease resulted in a gain or a loss to the taxpayer, is it proper to consider only the amount which the taxpayer received upon the cancellation and disregard the consideration given by the taxpayer to obtain such amount?

POINT I.

The cancellation of the lease resulted in a loss not a gain under the rule promulgated by the Circuit Court of Appeals, Seventh Circuit in a similar case which the Circuit Court of Appeals, Second Circuit has refused to follow in the present case.

There is good authority to support the petitioner's contention that the transaction in question resulted in a loss and not a gain of any kind, since the petitioner could not negotiate a new lease as favorable as the lease which was cancelled.

The identical question arose in 1931 in the Circuit Court of Appeals, Seventh Circuit.

Commissioner of Internal Revenue v. *Langwell Real Estate Corporation,* 47 Fed. (2) 841 (Seventh Circuit).

In the *Langwell* case, *supra,* a long term lease was cancelled by mutual consent of the lessee and of the taxpayer who was the owner of the premises by deed from the original lessor. (We shall refer to the transferee as the lessor.) At the time of the cancellation, the lessor held $50,000 of the lessee as security for the faithful performance by the lessee of the terms of the lease, said sum to be returned to the lessee at the expiration of the term, with interest. As the consideration for the cancellation it was agreed between the lessor and lessee, that the lessor keep the $50,000.

It was held by the Circuit Court of Appeals that the lessor was enriched in said sum, unless it appeared that the lessor "suffered a loss by reason of the termination of the lease." The sole test laid down by the Court for determining whether a loss was suffered is in the words of the Court:

> "If respondent could have readily negotiated another lease with a responsible party, as favorable as the lease which was cancelled, it suffered no loss. On the other hand, if it could not have negotiated such a lease, then it suffered a loss. The amount of such loss, if any, was the legitimate subject of proof. The actual execution of a new lease was not necessary to the determination of this issue. The rental value of such property could be shown by oral testimony."

The *Langwell* case is factually similar to the case on appeal so far as concerns the cancellation of the lease and the consideration therefor. Of course, it is wholly immaterial whether as in the *Langwell* case, it was agreed that the lessor was to retain absolutely a large sum then in its possession, which it otherwise

would have had to return to the lessee, or the lessor received a large sum from the lessee at the time of the cancellation.

In the *Langwell* case the matter was sent back by the Circuit Court to the Board of Tax Appeals for rehearing on the issue of loss. The Board found on the rehearing that the lessor had not suffered any loss on the evidence presented. (30 B. T. A. 145.)

No attempt will be made in this brief to review the evidence submitted on the hearing on the present appeal before the Tax Board as no attempt was made by the respondent to contradict the convincing evidence presented by the petitioner, that the premises could not be as favorably relet after the cancellation as they had been under the terms of the cancelled lease. The respondent appears not to question the sufficiency of this proof, but only that the principle laid down by the *Langwell* decision is erroneous and should not be followed.

The petitioner rested upon the precedent of the *Langwell* case both before the Board of Tax Appeals and the Circuit Court of Appeals, Second Circuit.

The underlying theory of the *Langwell* case is well supported by the law laid down by the Courts of New York State, which law affects the status of the lease in question as the real property is situated in New York and the tax return was filed in the New York District. Under the law of New York the lease was an asset of the petitioner with a definite appraisable value at the time of its cancellation. The petitioner was deprived of this valuable asset and the question as to whether a lease is a valuable asset is determinable by the rule laid down by the Courts of New York State. A similar rule was also applied in the *Langwell* case by the Circuit Court of Appeals.

Leaseholds Have Always Been Regarded in Law as Separate and Divisible From the Fee and Are Readily Evaluated in Law, Apart From the Fee, By Well Known and Recognized Rules.

The propriety of treating a lease as a distinct property interest apart from the fee has many times been adjudicated as has been the method of evaluating a lease apart from the fee value.

The question has arisen in a variety of cases such as inheritance tax proceedings, in re

Ralph H. Plumb, 7 B. T. A. 295.

Mortgage recording tax proceedings, in re

People, ex rel. U. S. Rubber Co. v. *Knoff,* 232 N. Y. 153.

Surplus money proceedings on mortgage foreclosures, in re

Larking v. *Misland,* 100 N. Y. 212.

Damages for the value of a lease extinguished by mortgage foreclosure.

Mack v. *Patchin,* 42 N. Y. 167.

Value of a lease for the purpose of determining the extent to which a lessee is entitled to share in surplus money proceedings resulting from a mortgage foreclosure.

Clarkson v. *Skidmore,* 46 N. Y. 297.

Invariably the courts have held in all such cases that a leasehold is in and of itself property which according to the facts and circumstances may have

value either to the lessor or lessee which can be definitely appraised.

Likewise it has been held that a leasehold can be a valuable asset of either the lessor or the lessee but cannot at the same time be an asset to both.

The test laid down by the courts is simple. A lease is an asset of value to the lessor if the rent payable to the lessor under the lease is greater than the rental value of the demised premises. If the rent payable is less than the rental value then the lease is a valuable asset to the lessee and a burden to the lessor.

This doctrine has long been established in the law and is based on good reason and sound business principles.

Thus in

Rae Company v. *Courtney,* 250 N. Y. 271.

A lease provided that the lessee had the option to purchase the building at a "proper consideration". The Court was called upon to fix the amount of the "proper consideration". It appeared that the lease in question had sixteen years to run at the time of the exercise of the option to purchase by the lessee. That the rent reserved in the lease was $2,000 a year and that the rental value of the demised premises was $4,000 a year. The Court held that the lease was a burden to the property as it was less than the rental value. The Court said at page 274:

> "If the lessors had desired to sell the premises subject to the lease, they would have been obliged to deduct from the market value of the property the amount of the encumbrance of the lease."

The Court held that the market value of the property without a lease was $100,000 but that the burden of the lease brought the market value down to $70,000 and that the purchaser was only required to pay the latter sum.

It is clear that this rule applies both ways and that if in a given case a lease is a profitable one to the property owner, that is, the rent reserved over a substantial period is greater than the rental value for the same period, the market value of the property must be increased accordingly.

This is clearly the law in the State of New York in which State the property in question is situated. The taxpayer is a resident of New York. The Estate through which the taxpayer originally inherited the property was administered in New York pursuant to the laws of New York. It therefore appears conclusively that in all proceedings, inheritance tax or otherwise in which the market value of the property in question was appraised, the foregoing rule governing appraisals of real property subject to a lease was employed.

It is therefore clear that the valuable and advantageous long term lease upon the premises owned by the taxpayer was an important element in fixing the value of the property in question in the Inheritance Tax Proceedings aforementioned and in any and all other proceedings brought to determine the market value of the property.

It is also apparent that it is manifestly unfair and unreasonable to have imposed a large Inheritance Tax upon this taxpayer by reason of the large value placed upon the property inherited by him in view of the fact that the property was subject to a lease of great advantage to the property and then, in the

present proceedings, ignore the fact that in losing such lease the taxpayer lost a valuable asset upon which he had previously paid a large tax.

It is apparent that the present case comes clearly within the decision of the *Langwell* case *supra* and that the *Langwell* decision is based upon a sound and accepted doctrine of law—that a leasehold in and of itself has a definite ascertainable value and its premature termination for a sum certain may result in gain or loss depending on the facts, just as in the case of other property, and may be the subject of a gain or loss like any other property.

POINT II.

The decision of the Second Circuit Court of Appeals, in this case, is based solely upon the authority of that Court's earlier decision in the *Warren Service Corporation* case. There is, however, a fundamental difference between the *Warren Service Corporation* case and the present case.

The difference to which we refer is that in the *Warren Service Corporation* v. *Commissioner of Internal Revenue,* 110 Fed. (2) 723, there was actual recoupment and probability of further recoupment of the taxpayer's loss on the cancellation of the lease since the premises continued to be owned by the taxpayer after the cancellation, and were relet by the taxpayer immediately thereafter for $30,000 per annum, later increased to $40,000 for a five-year term.

In the instant case, the record shows no recoupment to the taxpayer and that the loss of the property by mortgage foreclosure within a few months

after the cancellation made any recoupment impossible.

The Court in the *Warren Service Corporation* case makes specific mention in its opinion of the recoupment feature of that case. The Court says:

> "It (the taxpayer) urges that it surrendered a contractual right to receive annual rentals far in excess of any sum for which it has been able to relet the premises. But this does not establish a deductible loss in 1933 (the year of the cancellation), it shows merely a diminution of expected income during that year and subsequent years. The taxpayer has sustained no loss of property in the income tax sense. *The land and building were and still are owned by the taxpayer and they have produced income.*" (Italics ours.)

That decision was rendered in 1940 and apparently the proof in that case showed that seven years after the cancellation of the lease the relet property was still bringing a very substantial income to the taxpayer.

Likewise in the case of

> *H. T. Josey* v. *Commissioner of Internal Revenue,* 104 Fed. (2) 453, Tenth Circuit

cited in the opinion of the Court in the *Warren Service Corporation* case *supra,* the taxpayer continued to remain the owner of the real property subsequent to the cancellation of the lease, and actually received rental therefrom for a period of years thereafter. The fact that in the *Warren Service Corporation* case the taxpayer continued to hold title to the property was apparently considered an important

factor, which is evidenced also in the opinion of the Board of Tax Appeals in that case, which dwells upon the subject and cites authority to support its opinion on the point. 39 B. T. A. 856.

It therefore appears that in both the *Warren Service Corporation, supra,* case, and the *Josey* case, *supra,* there was lacking the necessary evidence that the loss was fixed beyond recoupment. In fact, the contrary appeared in both of said cases.

In the instant case we have not only the loss of the lease, but also the subsequent loss of the freehold following shortly thereafter, without any recoupment during the interim.

Such point as may be made by the respondent that the loss of the freehold has occurred in the following tax year and must be disregarded is discussed under Point III of this brief.

Upon a first reading of the opinion in the *Warren Service Corporation* case, *supra,* it would appear that the decision rested upon two independent grounds, to wit, that "there was merely a diminution of expected income during that year and subsequent years", and that "The land and building were and still are owned by the taxpayer and they have produced income". These grounds must be read together. The Court undoubtedly speaks of a diminution because the income during the year and subsequent years was actually diminished according to the facts of that case. The taxpayer still owned the property and was still receiving income therefrom after the cancellation of the lease. In fact, the premises in that case were practically relet to the same tenant but at a reduced rent. The word "diminution" could hardly have been used if the rent and income from the demised premises had entirely ceased, never to be restored in

any sum because the taxpayer had lost his ownership of the property as in the case at bar.

The Circuit Court in the *Warren Service Corporation* case, *supra,* further says: "The difference between the income actually received and the income the taxpayer had expected to receive is not a deductible loss. What has been lost is merely prospective income".

The fallacy is in applying this rule, if it be a proper rule, to the instant case where the loss is not merely one of prospective income, but the actual loss of income bearing property or property rights. The amount of monetary damage suffered by the loss of such property or property rights can be definitely computed according to the *Langwell* case and the other authorities cited herein under Point I.

It would therefore clearly appear that the *Warren Service Corporation* case, *supra,* furnished no authority to the Circuit Court of Appeals, Second Circuit, in reaching its determination in the case at bar.

POINT III.

There was no recoupment nor any possibility of recoupment in the case at bar.

It is immaterial that the loss of the freehold which followed the cancellation of the lease by a few months occurred during the subsequent tax year. The fact of its occurrence regardless of when it occurred, furnishes the proof that there could be no recoupment, provided, as is the case here, there was no recoupment in the interim.

Between the time of the cancellation of the lease and the loss of the real property by foreclosure, the

record shows that the demised premises were not re-rented. The cancellation occurred in December 1933. The foreclosure and receivership therein which deprived the taxpayer of possession and all right to collect rent occurred in March 1934 (R. 9). The foreclosure sale was in 1935 and clearly relates back to the date of the commencement of the action and the appointment of the receiver in March 1934. The formerly demised premises were not relet even in part until March 1st, 1937, by the successor in title (R. 51).

Thus all speculation as to the possibility of recoupment of the taxpayer is wholly avoided. There was no recoupment and none is possible.

It has been recently held by the Circuit Court of Appeals that the fact that the taxpayer continues to hold title to real property does not necessarily deprive him of the right to claim that he has lost the value of the property.

Rhodes v. *Commissioner of Internal Revenue,* 100 Fed. (2nd) 966, Sixth Circuit.

In the *Rhodes* case, *supra,* the taxpayer deducted a loss for real property which he claimed had become worthless because of hurricane damage, general business depression and reduction in land values. The property was sold for non-payment of taxes but the taxpayer had redemption rights. The Circuit Court of Appeals reversed the Board and held that a tax sale of real estate owned by the taxpayer together with evidence of the surrounding circumstances was such an identifiable event as would give ground for a loss on real property even though there were rights of redemption, and the taxpayer still retained title.

The reasons for the Circuit Court's reversal are

stated in its opinion in substance as follows at page 969:

> "Common sense interpretation is the safest rule to follow in the administration of income tax laws. Gross income and deductions flow from trade, commerce and dealings in property carried on in the ordinary business way, and in the determination of taxes men should measure both by ordinary every-day business standards.
>
> In arriving at losses the taxpayer should determine in the first instance the tax year in which sustained, and such deductions should be allowed by the Commissioner of Internal Revenue unless it appears from the facts that the taxpayer was clearly unreasonable and unfair at the time he was compelled to make his decision. Subsequent events may show a taxpayer to have been wrong but these must have been ascertainable by the exercise of ordinary business care and judgment at the time he made his income tax return."

At page 970:

> "The Board rested its decision largely on its rule that a loss on real estate is not deductible so long as the taxpayer retains title in fee.
>
> The unsoundness of this principle is readily apparent when subjected to the searchlight of reason. The ownership of real estate may become a burden with recurring taxes and the impossibility of finding a purchaser at any price. * * * The loss statute makes no distinction between real and personal property and there may be an abandonment of real estate in a very practical sense without the taxpayer divesting himself of legal title."

In *Denman* v. *Brumback,* 58 Fed. (2) 128 (Sixth Circuit) cited in the *Rhodes* case, a similar situation was presented. In that case the taxpayer claimed a loss because his real property had been rendered valueless by a heavy special tax assessment. The property was not disposed of by the taxpayer who continued to retain title, but he claimed an abandonment of the property which was sold the following year for non-payment of taxes. The Circuit Court of Appeals held that the loss was deductible. In referring to the rule followed by the Board that there must be a sale or closed transaction during the taxable year the Court said at page 129:

> "We think no such inflexible rule is to be found either in the statute or the regulation. We think the case falls within *United States* v. *White Dental Co.,* 247 U. S. 398."

In the *White* case cited *supra* this Court held at page 403 that "The Taxing Act does not require the taxpayer to be an incorrigible optimist." This Court held in that case that seizure of the taxpayer's property by a foreign power was a deductible loss even though there was a possibility that there might be recoupment by prosecution of the taxpayer's claim before the Mixed Claims Commission.

The fundamental difference between the facts in the case at bar on the question of recoupment and those in the *Warren Service Corporation* and the *Josey* cases, *supra,* makes the latter cases inapplicable.

POINT IV.

The Board of Tax Appeals distinctly found and held that the transaction was not a sale of property yet it applied to the case the rule of loss applicable to purchase and sale of property to wit, cost less amount realized on disposition. This was error.

One of the issues before the Board in this case was whether the gain if any was capital gain or ordinary income. The Board held that it was ordinary income since the transaction was not a sale or exchange of property in any sense. The Board stated in its opinion (p. 26):

> "Neither business men nor lawyers refer to the cancellation of a lease as a sale or exchange. The $140,000 received by the petitioner is not capital gain but is taxable to the petitioner as ordinary income."

Despite this ruling the Board held (p. 24):

> "The petitioner has failed to prove any figures from which a loss could be computed. A loss from the disposition of property is computed for income tax purposes by deducting the amount realized from the adjusted basis."

Later the Board states that "basis is always cost or some substitute therefor".

In one instance the Board holds that the transaction is not a sale or like disposition of property; in the other instance it holds that there is no loss because there has been no compliance with the rules of proof to establish loss on a sale or like disposition of property.

Since it has been held in this case that the transaction is not a sale or exchange of property, we must

examine the transaction as one from which income or profit arises other than from a sale or exchange. This being so, the existence or non-existence of an original cost plays no part in determining the net income.

The net income in such a transaction must always be the gross intake less the value of the consideration given for the intake less also deductible expenses. We are not concerned in this case with deductible expenses, but the value of the consideration surrendered by the taxpayer in order to entitle him to receive the intake must be deducted or a grave injustice has been done.

The consideration surrendered by the taxpayer as an essential to the consummation of the transaction were his rights, property and interest in a long term lease which the Courts have uniformly held to be a property right readily evaluated in the manner set forth under Point I hereof.

Where a transaction has resulted in a loss to the taxpayer, the taxpayer cannot, in justice and equity be assessed for a gain, and this is so even though there may be difficulty in finding a particular tax statute or rule applicable to the transaction.

The absence of such a statute or rule does not make just and equitable what is not so.

CONCLUSION.

The judgment of the Circuit Court of Appeals should be reversed.

Respectfully submitted,

WALTER J. ROSSTON,
EDWIN HORT,
Attorneys for Petitioner.

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In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 517

WALTER M. HORT, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT

The Government does not oppose the issuance of a writ in this case, but suggests that, if granted, it be limited to the first question presented in the petition.

1. The first question presented is whether, upon cancellation of a lease of real property, the lessor may deduct as a loss under Section 23 (e) of the Revenue Act of 1932 the difference, if any, between the value of the lease and the consideration received for its cancellation. The court below, relying on its own earlier decision in *Warren Service Corp.* v.

Commissioner, 110 F. (2d) 723, held that the lessor may not take such a deduction because a loss of prospective income is not a loss of property for income-tax purposes. Although we believe this decision to be plainly correct, it is in conflict with the decision of the Circuit Court of Appeals for the Seventh Circuit in *Commissioner* v. *Langwell Real Estate Corp.,* 47 F. (2d) 841.

2. The second question presented in the petition is whether, in the circumstances of this case, the court below erred in refusing to remand the case to the Board of Tax Appeals for a rehearing upon an alternative theory not presented to the Board on the original hearing. The refusal of the court below to remand is not in conflict with any decision of this Court or of any other circuit court of appeals, and it raises no question of importance.

Moreover, the court below was clearly correct in refusing to remand. The reason for the request to remand was to give the taxpayer an opportunity to prove that he suffered the loss of his equity in the property through foreclosure of a mortgage. The petition filed in the Board shows that the mortgagee commenced foreclosure proceedings in March 1934, that a receiver for the property was then appointed, and that a judgment of foreclosure and sale was entered in February 1935 (R. 9). The taxpayer testified that he lost the property through foreclosure in 1935 (R. 60) and the Board so found (R. 22). In these circumstances, it seems clear

that the taxpayer's loss of his equity occurred in 1935, after the taxable year, and that the court below, therefore, correctly refused to remand the case for further evidence on this point.

Respectfully submitted.

FRANCIS BIDDLE,
Solicitor General.

NOVEMBER 1940.

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In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 517

WALTER M. HORT, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 19) is reported in 39 B. T. A. 922. The *per curiam* opinion of the Circuit Court of Appeals (R. 71) is reported in 112 F. (2d) 167.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on June 12, 1940 (R. 72). Upon the application of the petitioner this Court extended

the time within which a petition for a writ of certiorari might be filed for a period of sixty days from August 24, 1940 (R. 75). The petition for a writ of certiorari was filed on October 18, 1940, and granted November 25, 1940, limited to the first question presented in the petition (R. 75). The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

Petitioner owned improved real estate upon a portion of which there was a long-term lease. During the tax year, he agreed to cancel the lease in return for the payment to him of $140,000. The questions are:

1. Whether, upon cancellation of the lease, petitioner realized taxable income in the amount of $140,000, or whether in computing the amount of gain or loss realized, there is to be offset against the $140,000 an amount equal to the value of the lease cancelled, or some other amount representing a capital investment in the lease.

2. If cancellation of the lease resulted in taxable income to petitioner in the amount of $140,000, whether petitioner is entitled to deduct as a loss under Section 23 (e) of the Revenue Act of 1932 an amount equal to the difference, if any, between the value of the lease cancelled and the consideration received for its cancellation.

STATUTE INVOLVED

The pertinent provisions of the Revenue Act of 1932, c. 209, 47 Stat. 169, appear in the Appendix, *infra*, pp. 28–30.

STATEMENT

The facts, as stipulated by the parties (R. 34–37) and as found by the Board of Tax Appeals (R. 21–22), may be summarized as follows:

Petitioner acquired by bequest from his father, who died in March 1928, certain real estate located on Madison Avenue in New York City. The real estate was improved with a ten-story commercial and office building. At the time of the father's death in 1928, the entire building was subject to a lease to Blum & Koch, which was to run until February 1, 1932. Blum & Koch, in turn, had sublet the main floor of the building to the Irving Trust Company, a substantial and financially responsible banking institution. The Irving Trust Company, desiring assurance that it would have possession of the premises beyond 1932, the date of the expiration of the lease to Blum & Koch, entered into a contract with petitioner's father in August 1927, whereby it leased the main floor and basement of the building from him for a term of fifteen years, to commence February 1, 1932, at an annual rental of $25,000 (R. 35, 21–22).

Petitioner, as executor of his father's estate, filed an estate tax return in which he reported the Madison Avenue property as having a fair market value of $650,000. This value was based upon an

appraisal of the property made by appraisers engaged by petitioner, as executor, in which the fair value of the property was set forth as follows: "Land and Building . . . $650,000.00." The estate tax was computed and paid on the basis of a $650,000 valuation for the property (R. 35–36, 21–22).

In June 1933 the Irving Trust Company discontinued the branch office which it had maintained in the building. It then sought to sublease the premises which it had occupied but, because of an unfavorable change in the character of the neighborhood, it was unable to find a subtenant willing to pay a rental of even $10,000 a year. It then negotiated with petitioner for cancellation of the lease, which still had over thirteen years to run. An agreement was reached whereby the lease was cancelled as of December 1, 1933, in return for a payment to petitioner on that date of $140,000. Petitioner lost the property through foreclosure in 1935 (R. 21–22, 36–37).

In his income tax return for the year 1933, petitioner reported a loss of $21,494.75 as a result of the cancellation of the lease,[1] but did not claim that amount as a deduction because other alleged capital

[1] Petitioner computed his alleged loss as follows: The rental payments due under the lease during the remainder of the term, discounted at 4 percent, have a present value of approximately $257,000. The estimated rentals, less brokerage fees, which the premises might be expected to bring for the period covered by the lease amount to approximately $96,000. Thus the value of the lease is computed

losses exceeded the gross income reported (R. 22, 37). The Commissioner determined that the $140,000 received by petitioner constituted income for the year 1933 and assessed a deficiency accordingly (R. 10–15). His action was approved by the Board of Tax Appeals (R. 22–26), and the court below affirmed (R. 72).

SUMMARY OF ARGUMENT

1. The consideration received by the petitioner for cancellation of the lease was income in its entirety. The lease cancelled was not a capital asset of the taxpayer; his capital consisted of the land and building, and the lease was merely a contractual right to receive, as income, fixed rentals for the use of a portion of the land and building. The consideration received for the cancellation of such a contractual right to receive future income is itself income in the year of its receipt. The payment here was made in substitution for the rents originally contemplated and stands in lieu of those rents; since the rents would have constituted income in their entirety, the payment made in lieu of those rents must likewise constitute income in its entirety.

2. Petitioner's contention to the contrary seems to be based primarily on the thesis that the cancellation of the lease constituted a disposition of

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to be $161,000 greater than the rental value of the premises. From this $161,000 petitioner deducted the cash payment of $140,000, leaving a net loss of approximately $21,000 (R. 6–7, 22).

property and that whether gain or loss resulted from the disposition is to be determined by comparing the value of the property disposed of with the price received for it. But it is clear that the determinative factor in computing gain or loss upon the disposition of property for income tax purposes is not the value of the property, as petitioner assumes, but the tax basis, cost or otherwise, of that property. The question here, then, is whether the lease cancelled during the tax year had any tax basis which is to be offset against the $140,000 received for its cancellation.

This question is not answered by mere assertion of the proposition that the lease is property; not all property has a tax basis which is to be offset against the consideration received for the property in determining gain or loss for income-tax purposes. It is only upon the disposition of property which, under the accounting system employed by the taxpayer, may properly be regarded as capital that the money received in exchange for the property is taxable other than as income in its entirety. Stated otherwise, property which is not a capital asset upon its acquisition by the taxpayer and which has not been transmuted into capital by passing through the door of income, has a basis of zero for purposes of determining gain or loss upon its disposition.

Leases may or may not, depending upon the circumstances of each case, be property which is to be considered as capital in the hands of the taxpayer.

A taxpayer who paid $100,000 for an assignment of the lessor's interest in a lease would have a capital investment of $100,000 in that lease; if it were cancelled the next day in return for a payment by the lessee of $100,000, the taxpayer would obviously have realized no gain. On the other hand, if a taxpayer makes a lease on his own property one day and several days later agrees to cancel the lease, or assigns the lease, in return for the payment to him of $100,000, he obviously realizes income of $100,000 because the lease does not represent capital in his hands. He has not spent anything to acquire the lease and the rental obligation cancelled or assigned has not been received and reported as income by him.

The present case must be decided in the light of these principles. The taxpayer may prevail only if he can show that the cancelled lease was property which, in his hands, represented capital. This showing he cannot make. The lease was plainly not capital in the hands of petitioner's father, and it was not transmuted into capital upon the father's death in 1928. The record does not show whether in 1928 the lease had any value; whatever value it might have had was not reported separately in the estate-tax return but was simply reflected as part of the $650,000 valuation placed upon the land and building. Thereafter the tax basis of the property in the hands of petitioner was $650,000; for purposes of income-tax accounting, however, that tax

basis is ascribed entirely to the land and building, which alone are considered as capital assets, the leases being treated as purely income items with a tax basis of zero.

Furthermore, petitioner has failed to show that in 1928 the Irving Trust Company lease, to commence in 1932, was of any value at all. Consequently, even if the lease be treated as a capital asset, it would still be property with a tax basis of zero and its disposition would therefore still result in gain to the full extent of the consideration received.

3. Petitioner also apparently urges that even if the cancellation of the lease resulted in a taxable gain of $140,000, petitioner should still be allowed to deduct as a loss under Section 23 (e) the difference between the value of the lease and the amount of the consideration received for its cancellation. The contention is without merit.

In order for petitioner to establish a deductible loss, he must prove either (a) that he disposed of property for an amount less than the tax basis of the property, or (b) that property which he retained became worthless during the tax year. The discussion above demonstrates that the cancellation of the lease did not constitute a disposition of property for less than its tax basis; a sale or other disposition of property which results in the realization of taxable gain cannot, by definition, result at the same time in a deductible loss. And the

lease was clearly not an asset retained by the taxpayer which became worthless during the tax year. The lease was neither retained by the taxpayer nor did it become worthless; it was cancelled in return for the payment of $140,000. At most, the taxpayer suffered a reduction in the rental value of the land and building which he continued to own. Such a depreciation in value does not constitute the realization of loss.

ARGUMENT

THE COMMISSIONER CORRECTLY DETERMINED THAT, UPON CANCELLATION OF THE LEASE, PETITIONER REALIZED INCOME IN THE AMOUNT OF $140,000

1. THE CONSIDERATION RECEIVED BY PETITIONER UPON CANCELLATION OF THE LEASE IS INCOME IN ITS ENTIRETY

At the beginning of the tax year, petitioner owned certain land and a building, a portion of which was subject to a lease to the bank. During the tax year, he agreed to cancel the lease to the bank in return for the payment of $140,000; he retained, however, the land and building and, presumably, leases on other portions of the building. He did not dispose of the land and building until 1935, when he lost the property at foreclosure sale.

In these circumstances, we believe it entirely clear that the consideration received by the petitioner for cancellation of the lease is income in its entirety. *Josey* v. *Commissioner,* 104 F. (2d) 453 (C. C. A. 10th); *Warren Service Corp.* v. *Commissioner,* 110 F. (2d) 723 (C. C. A. 2d); *Goerke*

Co. v. *Commissioner,* 7 B. T. A. 860; cf. *Taylor* v. *Commissioner,* 51 F. (2d) 915 (C. C. A. 3d); *Merckens* v. *Commissioner,* 7 B. T. A. 32; *Farrelly-Walsh, Inc.* v. *Commissioner,* 13 B. T. A. 923; Paul and Mertens, *Law of Federal Income Taxation,* Vol. 1, § 7.49. The lease cancelled was not a capital asset of the taxpayer; his capital consisted of the land and building, and the lease was merely a contractual right to receive, as income, fixed rentals to be paid by the bank for use of a part of the land and building. The consideration received for the cancellation of such a contractual right to receive future income is itself income in the year of its receipt. *Taylor* v. *Commissioner, supra; Goerke Co.* v. *Commissioner, supra; Merckens* v. *Commissioner, supra;* Paul and Mertens, *loc. cit. supra.*

It is not disputed that if the lease had continued according to its terms, the rental payments would have constituted income in their entirety to the petitioner. And it is similarly not disputed that expiration of the lease would not have affected the amount of petitioner's capital interest in the property as a whole. Since the rental payments would have constituted income and not a return of capital and since, upon expiration of the lease, petitioner's capital in the property would have been the same as it was upon commencement of the lease (except for depreciation), it is manifest that the rental obligation contained in the lease did not constitute a

capital asset. Accordingly, any payments received by petitioner in satisfaction of that obligation or as consideration for its cancellation must constitute income rather than a return of capital.

Stated otherwise, a payment in cancellation of an existing lease is made in substitution for the rent originally contemplated and stands in lieu of that rent;[2] if, as here, the rent would constitute income in its entirety when received, the payment made in lieu of rent must likewise constitute income in its entirety. In both cases, a rental obligation is relinquished in return for a sum of money; if the value of the obligation relinquished may not be deducted from the amount received in the one case (as it clearly may not be in the case of the receipt of rent), it may not be so deducted in the other case.

The fact, stressed by petitioner, that a contractual right to receive future income constitutes property is not relevant. If that right does not represent a capital investment by the taxpayer it does not constitute the type of property which is to be taken into consideration for income-tax purposes. The holder of a coupon bond who cashes an interest coupon realizes income in the amount of the interest payment, without any deduction for the value of the income right relinquished in order to

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[2] See Paul and Mertens, *Law of Federal Income Taxation*, Vol. 1, § 7.49; Magill, *When Is Income Realized*, 46 Harv. L. Rev. 933, 944.

receive the payment. Similarly, a lessor who relinquishes the right to rent in return for a rental payment realizes income in the amount of the rent without any deduction for the value of the right relinquished. And so, too, a lessor such as petitioner who relinquishes, by cancellation, a number of rental obligations in return for the payment of an agreed sum realizes income in the amount of the sum received without any deduction for the value of the obligations cancelled. In each case, the right to receive income which is relinquished, although a property right, is not property which may properly be treated as capital in the hands of the owner. Accordingly, money received upon disposition or relinquishment of the right cannot be considered as a return of capital but must be treated as income in its entirety.

2. PETITIONER'S CONTENTIONS

Petitioner, frankly admitting (Br. 19) that "there may be difficulty in finding a particular tax statute or rule" to support his contentions, seems to advance two different theories to avoid the force of our position. First, he apparently urges that the cancellation of the lease constituted a disposition of property and that by virtue of that disposition he suffered a loss rather than realizing a gain. Second, he apparently urges that, even if the cancellation of the lease resulted in a gain, he is entitled to deduct as a loss the difference between the value of the lease and the

consideration received for its cancellation. In advancing the first contention, petitioner treats the lease as property which has been disposed of during the tax year; in advancing the second contention, he treats the lease as property owned by him which has become worthless during the tax year. The two theories are thus inconsistent and mutually exclusive. In our view, neither theory is sound.

3. TREATING THE CANCELLATION OF THE LEASE AS A DISPOSITION OF PROPERTY, PETITIONER REALIZED INCOME IN THE AMOUNT OF $140,000

Petitioner's primary thesis seems to be that the cancellation of the lease constituted a disposition of property and that whether gain or loss resulted from the disposition is to be determined by comparing the value of the property disposed of with the price received for it.

The argument reveals a fundamental misconception of the structure of the income-tax law. Even in the case of the sale of property representing a capital investment by the taxpayer, gain or loss is not determined by comparing the value of the property sold with the consideration received for it; Section 111 (a) of the Revenue Act of 1932 specifically provides that "the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b), and the loss shall be the excess of such

basis over the amount realized." The determinative factor in computing gain or loss upon the disposition of property, therefore, is not the value of the property, as petitioner assumes, but the tax basis, cost or otherwise, of that property.[3] The question here, then, is whether the lease cancelled during the tax year had any tax basis which is to be offset against the $140,000 received for its cancellation.

This question is not answered by mere assertion of the proposition that the lease is "property." We do not question that proposition; indeed, we affirmatively rely upon it in support of our position in *Maass* v. *Higgins* and *Estate of Abendroth* v. *Commissioner,* Nos. 274 and 510–511, present Term, now under submission. But not all property has a tax basis which is to be offset against the consideration received for the property in determining gain or loss for income-tax purposes. It is only upon the disposition of

[3] Any gain realized upon the cancellation of a lease is taxable as ordinary income rather than as capital gain. Section 111 (a) of the 1932 Act provides the method for computing "the gain from the sale *or other disposition* of property"; that gain is to be treated as a capital gain, however, only if it results from a "sale or exchange" of property held by the taxpayer for more than two years. Section 101 (c) (1) and (8). The Board held in this case (R. 25–26), and petitioner no longer contends to the contrary, that the cancellation of a lease in consideration of a money payment is not a "sale or exchange." Cf. *Fairbanks* v. *United States,* 306 U. S. 436; *Hale* v. *Helvering,* 85 F. (2d) 819 (App. D. C.).

property which, under the accounting system employed by the taxpayer, may properly be regarded as capital that the money received in exchange for the property is taxable other than as income in its entirety. Stated otherwise, property which is not a capital asset upon its acquisition by the taxpayer and which has not been transmuted into capital by passing through the door of income, has a basis of zero for purposes of determining gain or loss upon its disposition.

A few illustrations will make this clear. A taxpayer on March 1, 1913, owns a contested and unliquidated claim for patent infringement. That claim is "property." *Erwin* v. *United States,* 97 U. S. 392, 395–396. Yet, because the claim is "so contingent and indefinite as to lack the quality of accrued income" and therefore cannot be considered as "property that has been transmuted into capital," any amount received by the taxpayer upon compromise of the claim is taxable income in its entirety. *United States* v. *Safety Car Heating Co.,* 297 U. S. 88, 94, 97. If, however, the owner of the claim assigned it after March 1, 1913, in return for a payment of money, the claim would represent a capital investment in the hands of the assignee to the extent of the payment. If the claim were then compromised, the assignee would have to be made whole for that capital investment before he realized any income. Thus, although the character of the claim as "property"

is plainly the same whether the claim be held by the original owner or by the assignee, its treatment for income tax purposes differs depending upon whether or not it is properly to be treated as capital from an income tax accounting standpoint.

Again, we may take the case of a taxpayer who in 1940 receives a note of a corporation representing salary owed to him for services rendered during that year. If the taxpayer is on a cash basis, so that the note is not received and returned as income in 1940, the note, although clearly property, is not property that, by passing through the door of income, has been transmuted into capital. Consequently, if the taxpayer sells the note in 1941, the full amount realized is income, the note being considered as property with a basis of zero. Similarly, if the taxpayer retains the note and the corporation goes into bankruptcy in 1941 before payment, the taxpayer will not be allowed a bad debt deduction. In other words, because the note was never received and reported as income, it never became a capital asset and consequently it is not an operative factor from an income tax accounting standpoint. On the other hand, if the same taxpayer had been on an accrual basis of accounting and had received and reported the note as income for 1940, it would be property transmuted into capital. Such a taxpayer would not derive income from a sale of the note in 1941 and would have a bad debt deduction if he re-

tained the note and the corporation went into bankruptcy in 1941 before payment. See Art. 192, Regulations 77; Paul and Mertens, *Law of Federal Income Taxation,* Vol. 3, § 28.19 and cases cited. And these divergent results are reached despite the fact that the character of the note as "property" is clearly the same in both situations.

The general principle, then, is that property which, under the system of accounting employed by the taxpayer, is not to be treated as "capital" because it was not a capital asset when acquired and was not transmuted into capital by passing through the door of income, is either to be disregarded or else to be regarded as having a basis of zero in determining gain or loss upon disposition of the property.

Leases may or may not, depending upon the circumstances of each case, be property which is to be considered as capital in the hands of the taxpayer. A taxpayer who paid $100,000 for an assignment of the lessor's interest in a lease would have a capital investment of $100,000 in that lease;[4] if it were cancelled the next day in return for a payment by the lessee of $100,000, the taxpayer would obviously have realized no gain. On

[4] Such a taxpayer would be entitled to a return of his capital investment before he realized income from the lease. This would be accomplished by allowing him to take as a deduction in his return an aliquot part of his investment each year, based on the number of years the lease has to run. Art. 130, Regulations 77.

the other hand, if a taxpayer makes a lease on his own property one day, and several days later agrees to cancel the lease in return for a payment to him of $100,000 (or assigns the lease for $100,000), he obviously realizes income of $100,000 because the lease does not represent capital in his hands. He has not spent anything to acquire the lease and the rental obligation cancelled or assigned has not been received and reported as income by him.

The present case must be decided in the light of these principles: the taxpayer may prevail only if he can show that the cancelled lease was property which, in his hands, represented capital. This the record fails to establish. The lease was originally made by petitioner's father in 1927; at that time it was clearly not a capital asset since it represented, not a capital investment, but merely a contractual right to future income from a portion of the land and building which petitioner's father owned. The term of the lease was not to commence until February 1, 1932, almost five years after its execution, when the then existing lease of the entire building to Blum & Koch was to expire.

The lease, not capital in the hands of petitioner's father, did not become transmuted into capital upon the father's death in 1928. The record does not show whether in 1928, the lease had any value; whatever value it might have had was not reported separately in the estate tax return but was simply

reflected as part of the value of the land and building. The land and building, subject to all leases, were reported at a value of $650,000. Under Section 113 (a) (5) of the 1932 Act, that amount represents the tax basis of the property in the hands of petitioner—his capital interest in the property.

Theoretically, it might be urged that this tax basis should be split up and a portion thereof ascribed to each component of value entering into the $650,000, i. e., the land and building, the lease to Blum & Koch, the lease of the first floor and basement to Irving Trust Company on and after February 1, 1932, any similar leases on other portions of the building, etc. Practically, however, the tax basis is, for income tax accounting purposes, ascribed to the land and building alone; a horizontal severance of capital cost into lease and reversionary interest is not permitted. This is shown by the fact that rental payments are considered income in their entirety and not a return of capital, and that the owner's capital investment in the premises is not considered affected by the termination of any leases thereon. See *Farmer* v. *Commissioner,* 1 B. T. A. 711; *Nelson Land & Oil Co.* v. *Commissioner,* 3 B. T. A. 315; *Du Pont* v. *Commissioner,* 18 B. T. A. 1028, 1035. No other theory of income tax accounting would either be feasible or accord with the concepts of capital and income normally employed in the business world. Cf. *Old Colony Railroad Co.* v. *Commissioner,* 284

U. S. 552, 560–561; *United States* v. *Kirby Lumber Co.*, 284 U. S. 1, 3; *United States* v. *Wurts*, 303 U. S. 414, 417. In the case at bar, for example, it would certainly not have been practicable for petitioner, upon his father's death, to have allocated his capital interest separately to the land and building, to the Blum & Koch lease, and to the Irving Trust lease. The only feasible course, and the only course which accords with common usage, is to consider the land and building as the capital asset and the leases as purely income items.

Furthermore, it can scarcely be contended that petitioner, on the present record, has established that in 1928 the lease to the Irving Trust Company, to commence in 1932, had any value whatsoever. Consequently, even if the lease be treated as a capital asset, it would still be property with a tax basis of zero and its disposition would therefore still result in gain to the full extent of the consideration received. Cf. *Josey* v. *Commissioner*, 104 F. (2d) 453 (C. C. A. 10th).

It is clear, therefore, that by whatever theory the question be approached, the Irving Trust lease was not property which, in the hands of the petitioner, had a tax basis to be offset against the $140,000 payment made for its cancellation. Accordingly, the Commissioner correctly determined that the transaction of cancellation gave rise to taxable income in the amount of $140,000.

4. PETITIONER IS NOT ENTITLED TO DEDUCT AS A LOSS THE DIFFERENCE, IF ANY, BETWEEN THE VALUE OF THE LEASE ON THE DATE OF CANCELLATION AND THE CONSIDERATION RECEIVED THEREFOR

Petitioner seems to urge that even if the transaction whereby the lease was cancelled in return for the $140,000 payment be considered as resulting in a taxable gain of $140,000, petitioner should still be allowed to deduct as a loss under Section 23 (e) of the Revenue Act of 1932 the difference between the value of the lease and the amount of the consideration received for its cancellation. The contention is, we submit, without substance.

The income tax law is in general concerned only with realized losses, as with realized gains. *Lucas* v. *American Code Co.*, 280 U. S. 445, 449. A mere reduction in the value of property owned by the taxpayer is not sufficient to entitle him to a deduction; his realization of loss must be evidenced by a closed transaction. *United States* v. *White Dental Co.*, 274 U. S. 398. In order for petitioner to establish a deductible loss in this case, therefore, he must prove either (a) that he disposed of property for an amount less than the tax basis of the property, or (b) that property which he retained became worthless during the tax year.

The discussion in the preceding pages of this brief amply demonstrates that the cancellation of the lease did not constitute a disposition of property for less than its tax basis; a sale or other

disposition of property which results in the realization of taxable gain cannot, by definition, result at the same time in a deductible loss. And, of course, petitioner's entire argument, based as it is on the theory that there was a disposition of the lease, is inconsistent with any contention that the lease constituted an asset retained by the taxpayer which became worthless during the tax year. The lease was neither retained by the taxpayer nor did it become worthless; it was cancelled in return for the payment of $140,000.

If we assume, contrary to apparent fact (see page 26, *infra*), that the cancellation was economically unfavorable to the petitioner, this would mean simply that the rental value of the land and building was reduced by the transaction. But since the petitioner continued to own the land and building throughout the taxable year, the reduction in its value cannot be treated as a realized loss, deductible under Section 23 (e). The loss, if any, would be realized and deductible only in 1935, when the property was sold at foreclosure sale (R. 9). *United States* v. *White Dental Co., supra; Helvering* v. *Hammel,* No. 49, present Term.

It is true that the decision in *Commissioner* v. *Langwell Real Estate Corp.,* 47 F. (2d) 841 (C. C. A. 7th), relied upon by petitioner, does support his position; in our view, however, that decision is patently wrong. There a lessee had made a deposit of $50,000 to secure the faithful

performance of the terms of a lease, the deposit to be returned by the landlord at the termination of the lease. Thereafter the landlord agreed to cancel the lease and the tenant agreed to relinquish all right to return of the deposit. The Commissioner determined that this transaction resulted in income of $50,000 to the landlord, but the Board of Tax Appeals reversed. Upon appeal, the Circuit Court of Appeals for the Seventh Circuit held (1) that upon the tenant's release of his interest in the deposit, the landlord realized income in the amount of $50,000; but (2) that by virtue of the same transaction the landlord could deduct as a loss the difference, if any, between the value of the lease and the rental value of the property. The cause was remanded to the Board to determine whether the landlord had in fact suffered such a loss.[5]

In our view, the *Langwell* decision is erroneous for reasons already stated. The record there showed no disposition of property for less than its tax base and no ascertainment during the tax year that any property retained by the taxpayer had become worthless. Consequently, the taxpayer suffered at most a reduction in the rental value of land and buildings which he continued to own—a depreciation in value which does not constitute the realization of loss. *United States* v. *White Dental*

[5] Upon remand, the Board determined that the taxpayer had not suffered a loss. 30 B. T. A. 145.

Co., supra; Lucas v. *American Code Co., supra.* The contrary decision of the court is based on the utterly untenable premise that a taxpayer may both derive a gain and suffer a loss as the result of the same transaction.

We have found no case in which the *Langwell* decision has been followed. The court below expressly disapproved it in *Warren Service Corp.* v. *Commissioner,* 110 F. (2d) 723, upon the authority of which the present case was decided. The court there stated (p. 724):

> The Board held that the cancellation of that obligation was income to the taxpayer in 1933. Assuming arguendo that this be true, the taxpayer contends that it sustained a loss by reason of the cancellation of the lease which more than offsets such income. It urges that it surrendered a contractual right to receive annual rentals far in excess of any sum for which it has been able to relet the premises. But this does not establish a deductible loss in 1933; it shows merely a diminution of expected income during that year and subsequent years. The taxpayer has sustained no loss of property in the income-tax sense. The land and building were and still are owned by the taxpayer and they have produced income. The difference between the income actually received and the income the taxpayer had expected to receive is not a deductible loss. What has been lost is merely prospective income. See *Josey* v. *Commissioner,* 10 Cir.,

> 104 F. (2d) 453, 455. If the case of *Commissioner* v. *Langwell Real Estate Corp.*, 7 Cir., 47 F. (2d) 841, is to be read as supporting the taxpayer's contention, we must respectfully decline to follow it, as did the Board.

And in *Josey* v. *Commissioner*, 104 F. (2d) 453, the Circuit Court of Appeals for the Tenth Circuit, in discussing a comparable contention made in connection with the cancellation of a sublease, stated (p. 455):

> When the Schulte sublease was cancelled, Josey surrendered a contractual right to receive annual rentals far in excess of what he is now receiving from the premises for a consideration of $10,000. This difference does not constitute a taxable loss since it has never been acquired and reported as income and for tax purposes that which has never been reported as income (unless its gain is nontaxable) has never been acquired. *Tiscornia* v. *Commissioner*, 9 Cir., 95 F. 2d 678, 683. In other words, had Josey continued to receive the rentals under the sublease, he would have had to report them as income. And not having received them, he suffered no deductible loss.

On the basis of these principles, we believe it clear that, even had the petitioner suffered an economic loss by reason of the cancellation of the lease, it would not be a loss which could be re-

flected in his income tax return until disposition of the land and building.

Furthermore, the assumption that petitioner suffered an economic loss is contradicted by the record. Petitioner would have sustained such a loss only if the value of the lease was greater than the consideration received for its cancellation. Since, however, the lessee was a financially responsible institution and, according to the testimony of its own real-estate manager, "could have paid the full $25,000 per year until the term of the lease expired in 1947" (R. 50), there is no reason to suppose that petitioner would have cancelled the lease for less than its full value. Indeed, just as the price at which property is sold is ordinarily the best evidence of the value of that property, so too the consideration agreed upon between landlord and financially responsible tenant for cancellation of a lease is ordinarily the best evidence of the value of that lease. The agreement between petitioner and the Irving Trust Company is therefore persuasive proof that the value of the lease was $140,000, the amount paid for its cancellation. The record contains no proof supporting any other valuation.

We submit, therefore, that under no theory did petitioner suffer a deductible loss which he may offset against the $140,000 taxable income realized upon cancellation of the lease.

CONCLUSION

The decision of the court below should be affirmed.

Respectfully submitted.

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MARCH 1941.

APPENDIX

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 22. GROSS INCOME.

(a) *General Definition.* "Gross income" includes gains, profits, and income derived from * * * dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * * *.

* * * * *

SEC. 23. DEDUCTIONS FROM GROSS INCOME:

In computing net income there shall be allowed as deductions:

* * * * *

(e) *Losses by Individuals.*—Subject to the limitations provided in subsection (r) of this section, in the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

* * * * *

SEC. 101. CAPITAL NET GAINS AND LOSSES.

* * * * *

(c) *Definitions.*—For the purpose of this title—

(1) "Capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

* * * * *

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b), and the loss shall be the excess of such basis over the amount realized.

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(5) *Property transmitted at death.*—If personal property was acquired by specific bequest, or if real property was acquired by general or specific devise or by intestacy, the basis shall be the fair market value of the property at the time of the death of the decedent. If the property was acquired by the decedent's estate from the decedent, the basis in the hands of the estate shall be the fair market value of the property at the time of the death of the decedent. In all other cases if the property was acquired either by will or by intestacy, the basis shall be the fair market value of the property at the time of the distribution to the taxpayer. In the case of property transferred in trust to pay the income for life to or upon the order or

direction of the grantor, with the right reserved to the grantor at all times prior to his death to revoke the trust, the basis of such property in the hands of the persons entitled under the terms of the trust instrument to the property after the grantor's death shall, after such death, be the same as if the trust instrument had been a will executed on the day of the grantor's death.

* * * * * *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

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SUPREME COURT OF THE UNITED STATES.

No. 517.—October Term, 1940.

Walter M. Hort, Petitioner, *vs.* Commissioner of Internal Revenue, Respondent.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[March 31, 1941.]

Mr. Justice Murphy delivered the opinion of the Court.

We must determine whether the amount petitioner received as consideration for cancellation of a lease of realty in New York City was ordinary gross income as defined in § 22(a) of the Revenue Act of 1932 (47 Stat. 169, 178), and whether, in any event, petitioner sustained a loss through cancellation of the lease which is recognized in § 23(e) of the same Act (47 Stat. 169, 180).

Petitioner acquired the property, a lot and ten-story office building, by devise from his father in 1928. At the time he became owner, the premises were leased to a firm which had sublet the main floor to the Irving Trust Co. In 1927, five years before the head lease expired, the Irving Trust Co. and petitioner's father executed a contract in which the latter agreed to lease the main floor and basement to the former for a term of fifteen years at an annual rental of $25,000, the term to commence at the expiration of the head lease.

In 1933, the Irving Trust Co. found it unprofitable to maintain a branch in petitioner's building. After some negotiations, petitioner and the Trust Co. agreed to cancel the lease in consideration of a payment to petitioner of $140,000. Petitioner did not include this amount in gross income in his income tax return for 1933. On the contrary, he reported a loss of $21,494.75 on the theory that the amount he received as consideration for the cancellation was $21,494.75 less than the difference between the present value of the unmatured rental payments and the fair rental value of the main floor and basement for the unexpired term of the lease. He did not deduct this figure, however, because he reported other losses in excess of gross income.

The Commissioner included the entire $140,000 in gross income, disallowed the asserted loss, made certain other adjustments not material here, and assessed a deficiency. The Board of Tax Appeals affirmed. 39 B. T. A. 922. The Circuit Court of Appeals affirmed per curiam on the authority of *Warren Service Corp.* v. *Helvering*, 110 F. (2d) 723. 112 F. (2d) 167. Because of conflict with *Commissioner* v. *Langwell Real Estate Corp.*, 47 F. (2d) 841, we granted certiorari limited to the question whether, "in computing net gain or loss for income tax purposes, a taxpayer [can] offset the value of the lease canceled against the consideration received by him for the cancellation". 311 U. S. —.

Petitioner apparently contends that the amount received for cancellation of the lease was capital rather than ordinary income and that it was therefore subject to §§ 101, 111-113, and 117 (47 Stat. 169, 191, 195-202, 207) which govern capital gains and losses. Further, he argues that even if that amount must be reported as ordinary gross income he sustained a loss which § 23(e) authorizes him to deduct. We cannot agree.

The amount received by petitioner for cancellation of the lease must be included in his gross income in its entirety. Section 22(a), copied in the margin,[1] expressly defines gross income to include "gains, profits, and income derived from . . . rent, . . . or gains or profits and income from any source whatever". Plainly this definition reached the rent paid prior to cancellation just as it would have embraced subsequent payments if the lease had never been canceled. It would have included a prepayment of the discounted value of unmatured rental payments whether received at the inception of the lease or at any time thereafter. Similarly, it would have extended to the proceeds of a suit to recover damages had the Irving Trust Co. breached the lease instead of concluding a settlement. Compare *United States* v. *Safety Car Heating Co.*, 297 U. S. 88; *Burnet* v. *Sanford*, 282 U. S. 359. That the amount petitioner received resulted from negotiations ending in cancellation of the

[1] Sec. 22(a). "Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

lease rather than from a suit to enforce it cannot alter the fact that basically the payment was merely a substitute for the rent reserved in the lease. So far as the application of § 22(a) is concerned, it is immaterial that petitioner chose to accept an amount less than the strict present value of the unmatured rental payments rather than to engage in litigation, possibly uncertain and expensive.

The consideration received for cancellation of the lease was not a return of capital. We assume that the lease was "property", whatever that signifies abstractly. Presumably the bond in *Helvering* v. *Horst*, 311 U. S. 112, and the lease in *Helvering* v. *Bruun*, 309 U. S. 461, were also "property", but the interest coupon in *Horst* and the building in *Bruun* nevertheless were held to constitute items of gross income. Simply because the lease was "property" the amount received for its cancellation was not a return of capital, quite apart from the fact that "property" and "capital" are not necessarily synonymous in the Revenue Act of 1932 or in common usage. Where, as in this case, the disputed amount was essentially a substitute for rental payments which § 22(a) expressly characterizes as gross income, it must be regarded as ordinary income, and it is immaterial that for some purposes the contract creating the right to such payments may be treated as "property" or "capital".

For the same reasons, that amount was not a return of capital because petitioner acquired the lease as an incident of the realty devised to him by his father. Theoretically, it might have been possible in such a case to value realty and lease separately and to label each a capital asset. Compare *Maass* v. *Higgins*, No. 274, decided March 3, 1941; *Appeal of Farmer*, 1 B. T. A. 711. But that would not have converted into capital the amount petitioner received from the Trust Co. since § 22(b)(3)[2] of the 1932 Act (47 Stat. 169, 178) would have required him to include in gross income the rent derived from the property, and that section, like § 22(a), does not distinguish rental payments and a payment which is clearly a substitute for rental payments.

We conclude that petitioner must report as gross income the entire amount received for cancellation of the lease without regard

[2] Sec. 22(b). The following items shall not be included in gross income and shall be exempt from taxation under this title: . . . .

(3) The value of property acquired by gift, bequest, devise, or inheritance (but the income from such property shall be included in gross income).

to the claimed disparity between that amount and the difference between the present value of the unmatured rental payments and the fair rental value of the property for the unexpired period of the lease. The cancellation of the lease involved nothing more than relinquishment of the right to future rental payments in return for a present substitute payment and possession of the leased premises. Undoubtedly it diminished the amount of gross income petitioner expected to realize, but to that extent he was relieved of the duty to pay income tax. Nothing in § 23(e)[3] indicates that Congress intended to allow petitioner to reduce ordinary income actually received and reported by the amount of income he failed to realize. See *Warren Service Corp.* v. *Commissioner, supra; Josey* v. *Commissioner,* 104 F. (2d) 453; *Tiscornia* v. *Commissioner,* 95 F. (2d) 678; *Farrelly-Walsh Inc.* v. *Commissioner,* 13 B. T. A. 923; *Gercke Co.* v. *Commissioner,* 7 B. T. A. 860; *Merckens* v. *Commissioner,* 7 B. T. A. 32. Compare, *United States* v. *Safety Car Heating Co., supra; Voliva* v. *Commissioner,* 36 F. (2d) 212; *Appeal of Denholm,* 2 B. T. A. 444. We may assume that petitioner was injured insofar as the cancellation of the lease affected the value of the realty. But that would become a deductible loss only when its extent had been fixed by a closed transaction. Regulations No. 77, Art. 171, p. 46; *United States* v. *White Dental Mfg. Co.,* 274 U. S. 398.

The judgment of the Circuit Court of Appeals is affirmed.

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[3] Sec. 23(e). Subject to the limitations provided in subsection (r) of this section, in the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise [shall be deductible from gross income]—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft. No loss shall be allowed as a deduction under this paragraph if at the time of the filing of the return such loss has been claimed as a deduction for estate tax purposes in the estate tax return.